ROLLERBALL INTERNATIONAL INC
Form NT 10-K
March 30, 2001

Form 12b-25

SEC 1344
(7-2000)
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 12b-25
SEC FILE NUMBER
CUSIP NUMBER
NOTIFICATION OF LATE FILING
(Check One): x Form 10-K Form 20-F Form 11-K Form 10-Q
Form N-SAR
For Period Ended: __December 31, 2000____________________
[ ] Transition Report on Form 10-K
[ ] Transition Report on Form 20-F
[ ] Transition Report on Form 11-K
[ ] Transition Report on Form 10-Q
[ ] Transition Report on Form N-SAR
For the Transition Period Ended: ___________________

Read Instruction (on back page) Before Preparing Form. Please Print or Type.

Nothing in this form shall be construed to imply that the Commission has verified any information contained herin.

If the notification relates to a portion of the filing checked above, identify the Item(s) to which the notification relates:

PART I -- REGISTRANT INFORMATION

___RollerBall International Inc.____
Full Name of Registrant

Former Name if Applicable

___9255 Doheny Road, Suite 602_____
Address of Principal Executive Office (Street and Number)

___Los Angeles, CA 90069_________
City, State and Zip Code

PART II -- RULES 12b-25(b) AND (c)

If the subject report could not be filed without unreasonable effort or expense and the registrant seeks relief pursuant to Rule 12b-25(b), the following should be completed. (Check box if appropriate)

X (a) The reasons described in reasonable detail in Part III of this form could not be eliminated without unreasonable effort or expense;

X (b) The subject annual report, semi-annual report, transition report on

Form 10-K, Form 20-F,11-K or Form N-SAR, or portion thereof, will be filed on or before the fifteenth calendar day following the prescribed due date; or the subject quarterly report of transition report on Form 10-Q, or portion thereof will be filed on or before the fifth

X (c) The accountant's statement or other exhibit required by Rule 12b-25(c) has been attached if applicable.

PART III -- NARRATIVE

State below in reasonble detail the reasons why Forms 10-K, 20-F, 11-K, 10-Q, N-SAR, or the transition report portion thereof, could not be filed within the prescribed time period.

(Attach Extra Sheets if Needed)

RIDER ATTACHED

PART IV-- OTHER INFORMATION

(1) Name and telephone number of person to contact in regard to this notification

__JAMES HARTNETT__________________________
(Name)
__310_________________________
(Area Code)
___275-5313________________________
(Telephone Number)

(2) Have all other periodic reports reports required under Section 13 or 15(d) of the Securities Exchange Act of 1934 or Section 30 of the Investment Company Act of 1940 during the preceeding 12 months or for such shorter period that the registrant was required to file such report(s) been filed? If answer is no, identify report(s). Yes x No

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(3) Is it anticipated that any significant change in results of operations from the corresponding period for the last fiscal year will be reflected by the earnings statements to be included in the subject report or portion thereof?
Yes No x

If so, attach an explanation of the anticipated change, both narratively and quantitatively, and, if appropriate, state the reasons why a reasonable estimate of the results cannot be made.

_____ROLLERBALL INTERNATIONAL INC.____
(Name of Registrant as Specified in Charter)

has caused this notification to be signed on its behalf by the undersigned hereunto duly authorized.

Date__MARCH 29, 2001______________________ By______/S/ JACK FORCELLEDO_________

INSTRUCTION: The form may be signed by an executive officer of the registrant of by any other duly authorized representative. The name and title of the person signing the form shall be typed or printed beneath the signature. If the statement is signed on behalf of the registrant by an authorized representative (orther than an executive officer), evidence of the representative's authority to sign on behalf of the registrant shall be filed with the form.

ATTENTION

International misstatements or omissions of fact constitute Federal Criminal Violations (See 18 U.S.C. 1001).

General Instructions

1. This form is required by Rule 12b-25 (17 CFR 240.12b-25) of the General Rules and Regulations under the Securities Exchange Act of 1934.

2. One signed original and four conformed copies of this form and amendments

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thereto must be completed and filed with the Securities and Exchange Commission,
Washington, D.C. 20549, in accordance with Rule0-3 of the General Rules and
Regulations under the Act. The information contained in or filed with the form
will be made a matter of public record in the Commission files.
3. A manually signed copy of the form and amendments thereto shall be filed with
each national securities exchange on which any class of securities of the
registrant is registered.
4. Amendments to the notifications must also be filed on form 12b-25 but need
not restate information that has been correctly furnished. The form shall be
clearly indentified as an amended notification.
5. Electronic filers. This form shall not be used by electronic filers unable to
timely file a report solely due to electronic difficulties. Filers unable to
submit a report within the time period prescribed due to difficulties in
electronic filing should comply with either Rule 201 or Rule 202of Regulation
S-T (232.201 or 232.202 of this chapter) or apply for an adjustment in filing
date pursuant to Rule 13(b) of Regulation S-T (232.13(b) of this Chapter).

PART III                        ROLLERBALL INTERNATIONAL INC.

        The Registrant was unable to file its Form 10-K for the fiscal year
ended December 31, 2000, without unreasonable expense and effort due to its
inability to compile the information to finish the required financial statements
with sufficient time for management to review the financial statements and to
prepare the management discussion and analysis.


http://www.sec.gov/divisions/corpfin/forms/12b-25.htm
Last update: 07/20/2000
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ring the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of May 4, 2015, 85,610,560 shares of $0.0001 par value common stock were outstanding.

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Gogo Inc.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Gogo Inc. and Subsidiaries

Unaudited Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)

	March 31, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$ 400,056	$ 211,236
Accounts receivable, net of allowances of $584 and $774, respectively	42,233	48,509
Inventories	24,124	21,913
Prepaid expenses and other current assets	12,615	13,236
Total current assets	479,028	294,894
Non-current assets:		
Property and equipment, net	396,001	363,108
Intangible assets, net	79,222	78,464
Goodwill	620	620
Long-term restricted cash	7,874	7,874
Debt issuance costs	18,008	11,296
Other non-current assets	9,405	11,384
Total non-current assets	511,130	472,746
Total assets	$ 990,158	$ 767,640
Liabilities and Stockholders equity		
Current liabilities:		
Accounts payable	$ 21,856	$ 41,026
Accrued liabilities	57,418	52,894
Accrued airline revenue share	13,227	13,273
Deferred revenue	29,895	20,181
Deferred airborne lease incentives	16,090	13,767
Current portion of long-term debt and capital leases	9,799	10,345
Total current liabilities	148,285	151,486

Non-current liabilities:		
Long-term debt	562,715	301,922
Deferred airborne lease incentives	91,720	83,794
Deferred tax liabilities	6,805	6,598
Other non-current liabilities	40,870	26,082
Total non-current liabilities	702,110	418,396
Total liabilities	850,395	569,882
Stockholders equity		
Common stock, par value $0.0001 per share; 500,000,000 shares authorized at March 31, 2015 and December 31, 2014; 85,745,391 and 85,483,300 shares issued at March 31, 2015 and December 31, 2014, respectively; and 85,562,865 and 85,300,774 shares outstanding at March 31, 2015 and December 31, 2014, respectively	9	9
Additional paid-in-capital	846,950	884,205
Accumulated other comprehensive loss	(1,848)	(1,200)
Accumulated deficit	(705,348)	(685,256)
Total stockholders equity	139,763	197,758
Total liabilities and stockholders equity	$ 990,158	$ 767,640

See the Notes to Unaudited Condensed Consolidated Financial Statements

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Gogo Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Operations

(in thousands, except per share amounts)

	For the Three Months Ended March 31, 2015	2014
Revenue:		
Service revenue	$ 95,406	$ 72,291
Equipment revenue	20,105	23,403
Total revenue	115,511	95,694
Operating expenses:		
Cost of service revenue (exclusive of items shown below)	45,547	39,628
Cost of equipment revenue (exclusive of items shown below)	9,458	9,986
Engineering, design and development	17,085	14,099
Sales and marketing	10,241	8,042
General and administrative	24,193	17,572
Depreciation and amortization	18,777	15,687
Total operating expenses	125,301	105,014
Operating loss	(9,790)	(9,320)
Other (income) expense:		
Interest income	(5)	(15)
Interest expense	10,095	7,248
Other (income) expense	(82)	40
Total other expense	10,008	7,273
Loss before incomes taxes	(19,798)	(16,593)
Income tax provision	294	273
Net loss	$ (20,092)	$ (16,866)
Net loss attributable to common stock per share basic and diluted	$ (0.24)	$ (0.20)
Weighted average number of shares basic and diluted	83,126	84,995

See the Notes to Unaudited Condensed Consolidated Financial Statements

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Gogo Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Comprehensive Loss

(in thousands)

	For the Three Months Ended March 31, 2015	2014
Net loss	$ (20,092)	$ (16,866)
Currency translation adjustments, net of tax	(648)	(242)
Comprehensive loss	$ (20,740)	$ (17,108)

See the Notes to Unaudited Condensed Consolidated Financial Statements

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Gogo Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)

	For the Three Months Ended March 31,	
	2015	**2014**
Operating activities:		
Net loss	$ (20,092)	$ (16,866)
Adjustments to reconcile net loss to cash provided by (used in) operating activities:		
Depreciation and amortization	18,777	15,687
Loss on asset disposals/abandonments	760	186
Deferred income taxes	207	207
Stock compensation expense	3,085	1,604
Amortization of deferred financing costs	784	836
Accretion of debt discount	972	
Changes in operating assets and liabilities:		
Accounts receivable	6,002	(3,979)
Inventories	(2,211)	1,953
Prepaid expenses and other current assets	585	(1,980)
Accounts payable	(10,176)	(2,475)
Accrued liabilities	1,290	(8,469)
Accrued airline revenue share	(44)	11
Deferred airborne lease incentives	8,670	5,566
Deferred revenue	10,216	1,163
Deferred rent	14,800	(15)
Other non-current assets and liabilities	(19)	(238)
Net cash provided by (used in) operating activities	33,606	(6,809)
Investing activities:		
Purchases of property and equipment	(52,610)	(31,907)
Acquisition of intangible assets capitalized software	(4,253)	(4,188)
Decrease (increase) in restricted cash	19	(2,499)
Net cash used in investing activities	(56,844)	(38,594)
Financing activities:		
Proceeds from the issuance of convertible notes	361,940	
Forward transactions	(140,000)	
Payment of issuance costs	(9,492)	
Payment of debt, including capital leases	(3,133)	(2,003)
Stock option exercises	2,554	626

Net cash provided by (used in) financing activities	211,869	(1,377)
Effect of exchange rate changes on cash	189	10
Increase (decrease) in cash and cash equivalents	188,820	(46,770)
Cash and cash equivalents at beginning of period	211,236	266,342
Cash and cash equivalents at end of period	$ 400,056	$ 219,572
Supplemental Cash Flow Information:		
Cash paid for interest	$ 8,017	$ 6,811
Cash paid for taxes	38	25
Noncash Investing and Financing Activities:		
Purchases of property and equipment in current liabilities	$ 23,330	$ 13,565
Purchases of property and equipment paid by commercial airlines	1,915	495
Purchases of property and equipment under capital leases	18	1,807
Acquisition of intangible assets in current liabilities	1,555	2,269
Asset retirement obligation incurred	204	973
Financing costs included in current liabilities	865	

See the Notes to Unaudited Condensed Consolidated Financial Statements

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Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

1. Basis of Presentation

The Business - Gogo Inc. (we , us , our) is a holding company, which through its operating subsidiaries is a provider of in-flight connectivity and wireless in-cabin digital entertainment solutions. We operate through the following three segments: Commercial Aviation North America or CA-NA , Commercial Aviation Rest of World or CA-ROW and Business Aviation or BA . Services provided by our CA-NA and CA-ROW businesses include Gogo Connectivity, which allows passengers to connect to the internet from their personal Wi-Fi-enabled devices, Gogo Vision, which offers passengers the opportunity to enjoy a broad selection of in-flight entertainment options on their personal Wi-Fi enabled devices, and other service revenue, which include a broad range of customizable, targeted content, advertising and e-commerce services. Services are provided by the CA-NA business on commercial aircraft flying routes that generally begin and end within North America, which for this purpose includes the United States, Canada and Mexico. Our CA-ROW business, which is in the start-up phase as we launched commercial international service in March 2014, provides service on commercial aircraft operated by foreign-based commercial airlines and international flights of North American based commercial airlines. The routes included in our CA-ROW segment are those that begin and/or end outside of North America (as defined above) for which our international service is provided. Our BA business provides in-flight internet connectivity and other voice and data communications products and services and sells equipment for in-flight telecommunications to the business aviation market. BA services include Gogo Biz, our in-flight broadband service which utilizes our ATG network and spectrum, Gogo Vision, and satellite-based voice and data services through our strategic alliances with satellite companies.

Basis of Presentation - The accompanying unaudited condensed consolidated financial statements and notes have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and in conformity with Article 10 of Regulation S-X promulgated under the Securities Act of 1933, as amended. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements and should be read in conjunction with our annual audited consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2014 as filed with the Securities Exchange Commission (SEC) on February 27, 2015 (the 2014 10-K). These unaudited condensed consolidated financial statements reflect, in the opinion of management, all material adjustments (which include only normally recurring adjustments) necessary to fairly state, in all material respects, our financial position, results of operations and cash flows for the periods presented.

The results of operations and cash flows for the three month period ended March 31, 2015 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2015.

We have one class of common stock outstanding as of March 31, 2015 and December 31, 2014.

Use of Estimates - The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, management evaluates the significant estimates and bases such estimates on historical experience and on various other assumptions believed to be reasonable under the circumstances. However, actual results could differ materially from those estimates.

Reclassifications **-** In order to conform to the current year presentation, certain amounts in our 2014 unaudited condensed consolidated statements of cash flows have been reclassified. Specifically, deferred rent of ($15) for the three month period ended March 31, 2014 has been presented separately from accrued liabilities in our unaudited condensed consolidated statements of cash flows.

2. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue From Contracts With Customers* (ASU 2014-09). This pronouncement outlines a single comprehensive model to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The core principle of ASU 2014-09 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. As originally proposed, this guidance was effective for annual reporting periods beginning on or after December 15, 2016, including interim periods within that reporting period, and early adoption was not permitted. In April 2015, the FASB voted to propose to defer the effective date by one year, to annual reporting periods beginning on or after December 15,

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

2017, including interim periods within that reporting period. The FASB also voted to permit early adoption of the guidance, but no earlier than the original effective date. We will adopt this guidance as of January 1, 2018. We are currently evaluating the impact of the adoption of this guidance on our financial position, results of operations and cash flows.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern* (ASU 2014-15). This pronouncement provides additional guidance surrounding the disclosure of going concern uncertainties in the financial statements and requires that management perform interim and annual assessments of an entity s ability to continue as a going concern within one year of the date the financial statements are issued. We will adopt this guidance as of January 1, 2017. We do not anticipate that the adoption of this guidance will result in additional disclosures.

In April 2015, the FASB issued ASU 2015-03, *Interest Imputation of Interest (Subtopic 835-30)* (ASU 2015-03), which requires that debt issuance costs be presented in the balance sheets as a direct deduction from the carrying amount of the related debt liability. The new requirement is effective for fiscal years beginning on or after December 15, 2015, and for interim periods within those fiscal years. Retrospective presentation is required for all comparable periods presented. We do not believe that the adoption of this guidance will have a material impact on our consolidated financial statements.

3. Net Loss Per Share

Basic and diluted net loss per share have been calculated using the weighted-average number of common shares outstanding for the period. The shares repurchased associated with the Forward Transactions (as defined and described in Note 8, Long-Term Debt and Other Liabilities) are considered participating securities requiring the two-class method to calculate basic and diluted earnings per share. Net earnings in future periods will be allocated between common shares and participating securities. In periods of a net loss, the shares associated with the Forward Transactions will not receive an allocation of losses, as the counterparties to the Forward Transactions are not required to fund losses. Additionally, the calculation of weighted average shares outstanding as of March 31, 2015 excludes approximately 7.2 million shares that will be repurchased as a result of the Forward Transactions.

As a result of the net loss for the three month periods ended March 31, 2015 and 2014, all of the outstanding shares of common stock underlying stock options, deferred stock units and restricted stock units were excluded from the computation of diluted shares outstanding because they were anti-dilutive.

The following table sets forth the computation of basic and diluted earnings per share for the three month periods ended March 31, 2015 and 2014; however, because of the undistributed losses the shares of common stock associated with the Forward Transactions are excluded from the computation of basic earnings per share in 2015 as undistributed losses are not allocated to these shares (*in thousands, except per share amounts*):

	For the Three Months Ended March 31, 2015	2014
Net loss	$ (20,092)	(16,866)
Less: Participation rights of the Forward Transactions		
Undistributed losses	$ (20,092)	$ (16,866)
Weighted-average common shares outstanding-basic and diluted	83,126	84,995
Net loss attributable to common stock per share-basic and diluted	$ (0.24)	$ (0.20)

4. Inventories

Inventories consist primarily of telecommunications systems and parts, and are recorded at the lower of cost (average cost) or market. We evaluate the need for write-downs associated with obsolete, slow-moving, and nonsalable inventory by reviewing net realizable inventory values on a periodic basis.

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Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Inventories as of March 31, 2015 and December 31, 2014, all of which were included within the BA segment, were as follows (*in thousands*):

	March 31, 2015	December 31, 2014
Work-in-process component parts	$ 18,190	$ 16,578
Finished goods	5,934	5,335
Total inventory	$ 24,124	$ 21,913

5. Composition of Certain Balance Sheet Accounts

Prepaid expenses and other current assets as of March 31, 2015 and December 31, 2014 were as follows (*in thousands*):

	March 31, 2015	December 31, 2014
Tenant improvement allowance receivables	$ 2,279	$ 5,406
Deposits and prepayments on satellite services	2,668	972
Restricted cash	25	45
Other	7,643	6,813
Total prepaid expenses and other current assets	$ 12,615	$ 13,236

Property and equipment as of March 31, 2015 and December 31, 2014 were as follows (*in thousands*):

	March 31, 2015	December 31, 2014
Office equipment, furniture, fixtures and other	$ 38,132	$ 32,289
Leasehold improvements	40,427	31,031
Airborne equipment	350,783	319,835
Network equipment	147,279	146,795

	576,621	529,950
Accumulated depreciation	(180,620)	(166,842)
Property and equipment, net	$ 396,001	$ 363,108

Other non-current assets as of March 31, 2015 and December 31, 2014 were as follows *(in thousands)*:

	March 31, 2015	December 31, 2014
Canadian ATG license payments *(1)*	$ 2,197	$ 2,417
Deposits on satellite and other airborne equipment	6,084	5,689
Deposits on furniture and fixtures		2,335
Other	1,124	943
Total other non-current assets	$ 9,405	$ 11,384

(1) See Note 17, Canadian ATG Spectrum License for further information.

Accrued liabilities as of March 31, 2015 and December 31, 2014 were as follows (*in thousands*):

	March 31, 2015	December 31, 2014
Employee compensation and benefits	$ 10,209	$ 13,211
Airborne equipment and installation costs	12,427	9,548
Airborne partner related accrued liabilities	8,966	7,718
Deferred rent	4,050	3,637
Other	21,766	18,780
Total accrued liabilities	$ 57,418	$ 52,894

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Other non-current liabilities as of March 31, 2015 and December 31, 2014 were as follows (*in thousands*):

	March 31, 2015	December 31, 2014
Deferred rent	$ 28,772	$ 14,390
Asset retirement obligations	6,459	6,153
Capital leases	3,396	3,813
Deferred revenue	1,243	741
Other	1,000	985
Total other non-current liabilities	$ 40,870	$ 26,082

6. Intangible Assets

Our intangible assets are comprised of both indefinite and finite-lived intangible assets. Intangible assets with indefinite lives and goodwill are not amortized, but are reviewed for impairment at least annually or whenever events or circumstances indicate the carrying value of the asset may not be recoverable. We perform our annual impairment tests of our indefinite-lived intangible assets and goodwill during the fourth quarter of each fiscal year. We reevaluate the useful life of the indefinite-lived intangible assets each reporting period to determine whether events and circumstances continue to support an indefinite useful life. The results of our annual indefinite-lived intangible assets and goodwill impairment assessments in the fourth quarter of 2014 indicated no impairment.

As of March 31, 2015 and December 31, 2014, our goodwill balance, all of which related to our BA segment, was $0.6 million.

Our intangible assets, other than goodwill, as of March 31, 2015 and December 31, 2014 were as follows (*in thousands, except for weighted average remaining useful life*):

	Weighted Average Remaining Useful Life (in years)	As of March 31, 2015			As of December 31, 2014		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized intangible assets:							

Software	2.6	$ 77,237	$ (38,136)	$ 39,101	$ 72,940	$ (35,075)	$ 37,865
Trademark/trade name	3.1	3,072	(2,940)	132	3,072	(2,929)	143
Aircell Axxess technology		4,129	(4,129)		4,129	(4,103)	26
OEM and dealer relationships	1.8	6,724	(5,490)	1,234	6,724	(5,322)	1,402
Service customer relationship	5.1	8,081	(2,998)	5,083	8,081	(2,747)	5,334
Other intangible assets	6.2	1,500	(111)	1,389	1,500	(89)	1,411
Total amortized intangible assets		100,743	(53,804)	46,939	96,446	(50,265)	46,181
Unamortized intangible assets:							
FCC Licenses		32,283		32,283	32,283		32,283
Total intangible assets		$ 133,026	$ (53,804)	$ 79,222	$ 128,729	$ (50,265)	$ 78,464

Amortization expense was $3.5 million and $2.6 million for the three month periods ended March 31, 2015 and 2014, respectively.

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Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Amortization expense for each of the next five years and thereafter is estimated to be as follows (*in thousands*):

Years ending December 31,	Amortization Expense
2015 (period from April 1 to December 31)	$ 12,600
2016	$ 16,326
2017	$ 10,775
2018	$ 3,640
2019	$ 2,470
Thereafter	$ 1,128

Actual future amortization expense could differ from the estimated amount as the result of future investments and other factors.

7. Warranties

Our BA segment provides warranties on parts and labor for our systems. Our warranty terms range from two to five years. Warranty reserves are established for costs that are estimated to be incurred after the sale, delivery, and installation of the products under warranty. The warranty reserves are determined based on known product failures, historical experience, and other available evidence, and are included in accrued liabilities in our unaudited condensed consolidated balance sheet. Our warranty reserve balance was $1.5 million and $1.1 million as of March 31, 2015 and December 31, 2014, respectively.

8. Long-Term Debt and Other Liabilities

Long-term debt as of March 31, 2015 and December 31, 2014 was as follows (*in thousands*):

	March 31, 2015	December 31, 2014
Amended and Restated Senior Term Facility	$ 306,702	$ 309,244
Convertible Notes	262,945	
Alaska Facility	882	1,008
Total debt	570,529	310,252
Less current portion of long-term debt	(7,814)	(8,330)

Total long-term debt	$ 562,715	$ 301,922

Convertible Notes On March 3, 2015, we issued $340.0 million aggregate principal amount of 3.75% Convertible Senior Notes due 2020 (the Convertible Notes) in a private offering to qualified institutional buyers, pursuant to Rule 144A under the Securities Act of 1933, as amended. We granted an option to the initial purchasers to purchase up to an additional $60.0 million aggregate principal amount of Convertible Notes to cover over-allotments, of which $21.9 million was subsequently exercised during March 2015, resulting in a total issuance of $361.9 million aggregate principal amount of Convertible Notes. We expect to use the net proceeds from the Convertible Notes, after giving effect of the Forward Transactions (as defined below), for working capital and other general corporate purposes, including potential costs associated with developing and launching our next-generation technology solutions and the acquisition of additional spectrum should it become available. The Convertible Notes mature on March 1, 2020 unless earlier repurchased or converted into shares of our common stock under certain circumstances described below. Upon maturity, we have the option to settle our obligation through cash, shares of common stock, or a combination of cash and shares of common stock. We pay interest on the Convertible Notes semi-annually in arrears on March 1 and September 1 of each year, beginning on September 1, 2015.

The $361.9 million of proceeds received from the issuance of the Convertible Notes were initially allocated between long-term debt (the liability component) at $261.9 million, and additional paid-in-capital, (the equity component) at $100.0 million, within the unaudited condensed consolidated balance sheet. The fair value of the liability component was measured using rates determined for similar debt instruments without a conversion feature. The carrying amount of the equity component, representing the conversion option, was determined by deducting the fair value of the liability component from the aggregate face value of the Convertible Notes. If we or the note holders elect not to settle the debt through conversion, we must settle the Convertible Notes at face value. Therefore, the liability component will be accreted up to the face value of the Convertible Notes, which will result in additional non-cash interest expense being recognized within the unaudited condensed consolidated statements of

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

operations through the Convertible Notes maturity date (see Note 9, Interest Costs for additional information). The effective interest rate on the Convertible Notes, including accretion of the notes to par and debt issuance cost amortization, was approximately 11.5% for the three month period ended March 31, 2015. The equity component will not be remeasured as long as it continues to meet the conditions for equity classification.

As of March 31, 2015, the outstanding principal on the Convertible Notes was $361.9 million, the unamortized debt discount was $99.0 million, and the net carrying amount of the liability component was $262.9 million, which was recorded as long-term debt within the unaudited condensed consolidated balance sheet.

We incurred approximately $10.4 million of issuance costs related to the issuance of the Convertible Notes during the three month period ended March 31, 2015. Of the $10.4 million of issuance costs incurred, $7.5 million and $2.9 million were recorded to deferred financing costs and additional paid-in capital, respectively, in proportion to the allocation of the proceeds of the Convertible Notes. The $7.5 million recorded as deferred financing costs on the unaudited condensed consolidated balance sheet is being amortized over the contractual term of the Convertible Notes using the effective interest method. See Note 9, Interest Costs for additional information.

The Convertible Notes had an initial conversion rate of 41.9274 common shares per $1,000 principal amount of the Convertible Notes, which is equivalent to an initial conversion price of approximately $23.85 per share of our common stock. Upon conversion, we currently expect to deliver cash up to the principal amount of the Convertible Notes then outstanding. With respect to any conversion value in excess of the principal amount, we currently expect to deliver shares of our common stock, unless we elect to deliver cash in lieu of all or a portion of such shares. The shares of common stock subject to conversion are excluded from diluted earnings per share calculations under the if-converted method as their impact is anti-dilutive.

Holders may convert notes, at their option, in multiples of $1,000 principal amount at any time prior to December 1, 2019, but only in the following circumstances:

- during any fiscal quarter beginning after the fiscal quarter ending June 30, 2015, if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during the last 30 consecutive trading days of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price of the Convertible Notes on each applicable trading day;

- during the five business day period following any five consecutive trading day period in which the trading price for the Convertible Notes is less than 98% of the average of the closing sale price of our common stock for each day during such five trading day period; or

- upon the occurrence of specified corporate events.

Regardless of whether any of the foregoing circumstances occurs, holders may convert their Convertible Notes, in multiples of $1,000 principal amount, at any time on or after December 1, 2019 until maturity.

In addition, if we undergo a fundamental change (as defined in the indenture governing the Convertible Notes), holders may, subject to certain conditions, require us to repurchase their Convertible Notes for cash at a price equal to 100% of the principal amount of the Convertible Notes to be purchased, plus any accrued and unpaid interest. In addition, if specific corporate events occur prior to the maturity date, we will increase the conversion rate for a holder who elects to convert their Convertible Notes in connection with such a corporate event in certain circumstances.

In connection with the issuance of the Convertible Notes, we paid approximately $140 million to enter into prepaid forward stock repurchase transactions (the Forward Transactions) with certain financial institutions, (the Forward Counterparties), pursuant to which we purchased approximately 7.2 million shares of common stock for settlement on or around the March 1, 2020 maturity date for the Convertible Notes, subject to the ability of each Forward Counterparty to elect to settle all or a portion of its Forward Transactions early. As a result of the Forward Transactions, total shareholders equity within our unaudited condensed consolidated balance sheet was reduced by approximately $140 million during the three month period ended March 31, 2015. Approximately 7.2 million shares of common stock that will be effectively repurchased through the Forward Transactions are treated as retired shares for basic and diluted EPS purposes although they remain legally outstanding.

Senior Debt On July 30, 2014, Gogo Intermediate Holdings LLC, Gogo Business Aviation LLC, f/k/a Aircell Business Aviation Services LLC (GBA), and Gogo LLC, as borrowers (the Borrowers), entered into an Amendment and Restatement Agreement (the Amendment) to the Credit Agreement dated as of June 21, 2012 and amended on April 4, 2013 (the Amended Senior Term Facility) among the Borrowers, the lenders named therein,

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and Morgan Stanley Senior Funding, Inc., as Administrative Agent and Collateral Agent. We refer to the Amendment and the Amended Senior Term Facility collectively as the Amended and Restated Senior Term Facility.

Prior to the Amendment, under the Amended Senior Term Facility we borrowed an aggregate principal amount of \$248.0 million (the Tranche B-1 Loans). Pursuant to the Amendment, we borrowed an aggregate additional principal amount of \$75.0 million (the Tranche B-2 Loans and, together with the Tranche B-1 Loans, the Loans). As of March 31, 2015 and December 31, 2014, we had \$306.7 million and \$309.2 million, respectively, outstanding under the Amended and Restated Senior Term Facility.

As of March 31, 2015, we were in compliance with the covenants, cash balance, reporting and notice requirements of the Amended and Restated Senior Term Facility and no event of default had occurred.

The maturity date of the Amended and Restated Senior Term Facility is March 21, 2018. Principal payments of \$1.7 million are due on the last day of each calendar quarter through December 31, 2017, with the remaining unpaid principal amount due and payable at maturity.

The interest rates applicable to the Tranche B-1 Loans are based on a fluctuating rate of interest measured by reference, at GBA s option, to either (i) a London inter-bank offered rate adjusted for statutory reserve requirements (LIBOR) (subject to a 1.50% floor) plus an applicable margin of 9.75% per annum, or (ii) an alternate base rate (Base Rate) (subject to a 2.50% floor) plus an applicable margin of 8.75% per annum. The interest rates applicable to the Tranche B-2 Loans are based on a fluctuating rate of interest measured by reference, at GBA s option, to either (i) LIBOR (subject to a 1.00% floor) plus an applicable margin of 6.50% per annum, or (ii) a Base Rate (subject to a 2.00% floor) plus an applicable margin of 5.50% per annum. As of March 31, 2015, all loans were outstanding as three month LIBOR loans, and the interest rates on the Tranche B-1 Loans and the Tranche B-2 Loans were 11.25% and 7.50%, respectively. We pay customary fees in respect of the Amended and Restated Senior Term Facility.

The Tranche B-2 Loans are secured by the same collateral and guaranteed by the same guarantors as the Tranche B-1 Loans. The call premiums, mandatory prepayments, covenants, events of default and other terms applicable to the Tranche B-2 Loans are also generally the same as the corresponding terms applicable to the Tranche B-1 Loans under the Amended and Restated Senior Term Facility.

We paid \$22.2 million of loan origination fees and financing costs related to the Amended and Restated Senior Term Facility, all but \$4.1 million of which have been accounted for as deferred financing costs. The \$4.1 million of fees that were not accounted for as deferred financing costs were fees incurred but not paid directly to the lenders in connection with the amendments in April 2013 and July 2014 and were expensed to interest expense. Total amortization expense of the deferred financing costs was \$0.7 million and \$0.8 million for the three month periods ended March 31, 2015 and 2014, respectively. Amortization expense is included in interest expense in the unaudited condensed consolidated statements of operations. As of March 31, 2015 and December 31, 2014, the balance of unamortized deferred financing costs related to the Amended and Restated Senior Term Facility was \$10.6 million and \$11.3 million, respectively, which was included as a separate line in our consolidated balance sheets.

Principal payments under the Amended and Restated Senior Term Facility for each of the next five years and thereafter are as follows *(in thousands)*:

Years ending December 31,	**Credit Facility**
2015 (period from April 1 to December 31)	$ 5,199
2016	$ 6,932
2017	$ 6,932
2018	$ 287,639
Thereafter	$

The credit agreement executed in connection with our Amended and Restated Senior Term Facility provides for mandatory prepayments and the ability to make optional prepayments. Based on historical and current expectations regarding cash flow generation, the credit agreement was structured to provide that any mandatory prepayments will be calculated based on the excess cash flows (as defined in the credit agreement) of GBA only. This calculation is made at the end of each fiscal year, with any required payments due no later than the 95th day following the end of

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the applicable fiscal year, and is based on GBA s debt leverage ratio. A leverage ratio of 3.25x or higher will trigger a mandatory prepayment of 50% of excess cash flows for the year, a leverage ratio of 2.0x or higher but less than 3.25x will trigger a mandatory prepayment of 25% of excess cash flows for the year and a leverage ratio of less than 2.0x will not trigger any mandatory prepayment of excess cash flows. The amount of any required mandatory prepayments will be reduced by the amount of any optional prepayments made during the applicable fiscal year. In the event actual results or a change in estimates triggers the mandatory prepayment, such prepayment amount will be reclassified from non-current liabilities to current liabilities in our consolidated balance sheet. We had no such mandatory prepayment classified as a current liability as of March 31, 2015. As of December 31, 2014, we calculated a mandatory prepayment of approximately $0.9 million, which was paid in March 2015.

We may voluntarily prepay the loans subject to conditions, prices and premiums as follows:

(i) On and prior to December 21, 2015, we may prepay the loans at par plus (a) 3.0% of the principal amount of the loans prepaid and (b) a make whole premium based on a discounted present value of the interest and principal payments due on such prepaid loans through December 21, 2015;

(ii) After December 21, 2015 but prior to December 21, 2016, we may prepay the loans at par plus 3.0% of the principal amount of loans prepaid;

(iii) On and after December 21, 2016, we may prepay the loans at par.

Alaska Financing - On November 2, 2010, we entered into a $4.1 million standby credit facility agreement (the Alaska Facility) with Alaska Airlines, Inc. (Alaska Airlines) to finance the construction of ATG network sites in Alaska. The Alaska Facility has a six-year term and an interest rate of 10% per annum, compounded and payable quarterly. As of March 31, 2015 and December 31, 2014, we had $0.9 million and $1.0 million, respectively, outstanding under the Alaska Facility. The entire $0.9 million outstanding balance as of March 31, 2015 is included in the current portion of long-term debt and capital leases in our unaudited condensed consolidated balance sheet as we paid in full and terminated the Alaska Facility in April 2015.

Pursuant to our equipment and revenue agreement with Alaska Airlines, the share of service revenue (revenue share) we pay Alaska Airlines increases as long as any amounts are outstanding under the Alaska Facility. Alaska Airlines revenue share increases by 300 basis points for service revenue generated on flights that use the ATG network in Alaska, until the principal and all accrued interest is paid in full. This incremental revenue share was less than $0.1 million for the three month periods ended March 31, 2015 and 2014 and is included in our unaudited condensed consolidated statements of operations as part of our interest expense.

Letters of Credit - We maintain several letters of credit totaling $7.9 million and $7.9 million as of March 31, 2015 and December 31, 2014, respectively. Certain of the letters of credit require us to maintain restricted cash accounts in a similar amount, and are issued for the benefit of the landlords at our current office locations in Itasca, Illinois;

Bensenville, Illinois; and Broomfield, Colorado; and our future office location in Chicago, Illinois.

9. Interest Costs

We capitalize a portion of our interest on funds borrowed during the active construction period of major capital projects. Capitalized interest is added to the cost of the underlying asset and amortized over the useful lives of the assets.

The following is a summary of our interest costs for the three month periods ended March 31, 2015 and 2014 *(in thousands)*:

	For the Three Months Ended March 31,	
	2015	**2014**
Interest costs charged to expense	$ 8,339	$ 6,412
Amortization of deferred financing costs	784	836
Accretion of debt discount	972	
Interest expense	10,095	7,248
Interest costs capitalized to property and equipment	66	223
Interest costs capitalized to software	304	326
Total interest costs	$ 10,465	$ 7,797

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10. Leases

Arrangements with Commercial Airlines Pursuant to contractual agreements with our airline partners, we place our equipment on commercial aircraft operated by the airlines for the purpose of delivering the Gogo® service to passengers on the aircraft. Depending on the agreement, we may be responsible for the costs of installing and deinstalling the equipment. Under one type of connectivity agreement we maintain legal title to our equipment; however, under a second, more prevalent type of connectivity agreement some of our airline partners make an upfront payment and take legal title to such equipment. The majority of the equipment transactions where legal title transfers are not deemed to be sales transactions for accounting purposes because the risks and rewards of ownership are not fully transferred due to our continuing involvement with the equipment, the length of the term of our agreements with the airlines, and restrictions in the agreements regarding the airlines use of the equipment. We account for these equipment transactions as operating leases of space for our equipment on the aircraft. The assets are recorded as airborne equipment on our unaudited condensed consolidated balance sheets, as noted in Note 5, Composition of Certain Balance Sheet Accounts. Any upfront equipment payments are accounted for as lease incentives and recorded as deferred airborne lease incentives on our unaudited condensed consolidated balance sheets and are recognized as a reduction of the cost of service revenue on a straight-line basis over the term of the agreement with the airline. We recognized $3.9 million and $2.6 million for the three month periods ended March 31, 2015 and 2014, respectively, as a reduction to our cost of service revenue in our unaudited condensed consolidated statements of operations. As of March 31, 2015, deferred airborne lease incentives of $16.1 million and $91.7 million are included in current and non-current liabilities, respectively, in our unaudited condensed consolidated balance sheet. As of December 31, 2014, deferred airborne lease incentives of $13.8 million and $83.8 million are included in current and non-current liabilities, respectively, in our condensed consolidated balance sheet.

The revenue share paid to our airline partners represents an operating lease payment and is deemed to be contingent rental payments, as the payments due to each airline are based on a percentage of our CA-NA and CA-ROW service revenue generated from that airline s passengers, which is unknown until realized. Therefore, we cannot estimate the lease payments due to an airline at the commencement of our contract with such airline. Rental expense related to the arrangements with commercial airlines included in cost of service revenue is primarily comprised of these revenue share payments offset by the amortization of the deferred airborne lease incentives discussed above. Such rental expenses totaled a net charge of $10.3 million and $9.9 million for the three month periods ended March 31, 2015 and 2014, respectively.

One contract with one of our airline partners requires us to provide our airline partner with a cash rebate of $1.8 million if our service is available on a specified number of aircraft in such airline partner s fleet on the preceding December 31, in June of each year from 2015 through 2023. Based upon the number of aircraft in service on December 31, 2014, we will be required to rebate $1.8 million to this airline in June 2015.

Leases and Cell Site Contracts We have lease agreements relating to certain facilities and equipment, which are considered operating leases. Rent expense for such operating leases was $4.3 million and $1.6 million for the three month periods ended March 31, 2015 and 2014, respectively. The increase is due to us incurring rent expense for the new Broomfield, CO and Chicago, IL offices beginning in the second half of 2014. Additionally, we have operating leases with wireless service providers for tower space and base station capacity on a volume usage basis (cell site leases), some of which provide for minimum annual payments. Our cell site leases generally provide for an initial noncancelable term of up to five years with up to four five-year renewal options. Total cell site rental expense was $2.3 million and $2.2 million for the three month periods ended March 31, 2015 and 2014, respectively.

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Annual future minimum obligations for operating leases for each of the next five years and thereafter, other than the arrangements we have with our commercial airline partners, as of March 31, 2015, are as follows (*in thousands*):

Years ending December 31,	Operating Leases
2015 (period from April 1 to December 31)	$ 16,512
2016	$ 21,055
2017	$ 17,694
2018	$ 15,011
2019	$ 14,395
Thereafter	$ 120,600

Equipment Leases We lease certain computer and network equipment under capital leases, for which interest has been imputed with an annual interest rate of 8.1% to 13.4%. As of March 31, 2015 the computer equipment leases were classified as part of office equipment, furniture, and fixtures and other in our unaudited condensed consolidated balance sheet at a gross cost of $1.3 million. As of March 31, 2015 the network equipment leases were classified as part of network equipment in our unaudited condensed consolidated balance sheet at a gross cost of $6.4 million. Annual future minimum obligations under capital leases for each of the next five years and thereafter, as of March 31, 2015, are as follows (*in thousands*):

Years ending December 31,	Capital Leases
2015 (period from April 1 to December 31)	$ 1,860
2016	2,282
2017	1,687
2018	318
Thereafter	
Total minimum lease payments	6,147
Less: Amount representing interest	(765)
Present value of net minimum lease payments	$ 5,382

The $5.4 million present value of net minimum lease payments as of March 31, 2015 has a current portion of $2.0 million included in current portion of long-term debt and capital leases and a non-current portion of $3.4 million included in other non-current liabilities.

11. Commitments and Contingencies

Contractual Commitments - We have agreements with airborne equipment vendors under which we have remaining commitments to purchase $12.7 million in satellite based systems and development services as of March 31, 2015. Such commitments will become payable as we receive the equipment and are provided the development services.

We have agreements with vendors to provide us with transponder and teleport satellite services. These agreements vary in length and amount and commit us to purchase transponder and teleport satellite services totaling approximately $25.7 million in 2015 (April through December), $33.4 million in 2016, $31.8 million in 2017, $15.3 million in 2018 and an amount less than $0.1 million in 2019.

Damages and Penalties - Certain of our agreements with our airline partners may require us to incur additional obligations as a result of the occurrence of specified events, some of which may be out of our control. One contract covering the international fleet of one of our airline partners requires us to provide a credit or refund of up to $25 million to our airline partner if a competing airline installs satellite connectivity systems on a certain number of aircraft in its international fleet more quickly than we install our system on the same number of aircraft in our airline partner s international fleet. The refund or credit will be eliminated in its entirety if we complete full installation of our airline partner s international fleet by January 1, 2015, which date has been extended by six months as a result of certain excusable delays, and has been and will continue to be reduced proportionately from the maximum amount for every installation that we complete before the competitor achieves the target. The amount of any such refund or credit depends on a number of facts and circumstances, such as the pace at which we install satellite systems on aircraft delivered to us by our airline partner, as well as some that are not under our control, including, but not limited to, the number of installable aircraft made available to us from our airline partner s international fleet, our

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competitor s ability to install an equal or greater quantity of satellite systems on such competing airline s international fleet and any current or future regulatory delays to the extent they are not excusable delays. Any refund or credit may only be applied toward the purchase of equipment or for a refund of amounts paid by the airline for previously purchased equipment. One contract with another of our airline partners obligates us to pay our airline partner up to $6 million in penalties and installation and other costs if we fail to receive certain regulatory approvals or fail to begin the installation of equipment related to the provision of satellite-based service by specified deadlines.

We have entered into a number of agreements with our airline partners that require us to provide a credit or pay liquidated damages to our airline partners on a per aircraft, per day or per hour basis if we are unable to install our equipment on aircraft by specified timelines or fail to comply with service level commitments. The maximum amount of future credits or payments we could be required to make under these agreements is uncertain because the amount of future credits or payments is based on certain variable inputs.

Indemnifications and Guarantees - In accordance with Delaware law, we indemnify our officers and directors for certain events or occurrences while the officer or director is, or was, serving at our request in such capacity. The maximum potential amount of future payments we could be required to make under this indemnification is uncertain and may be unlimited, depending upon circumstances. However, our Directors and Officers insurance does provide coverage for certain of these losses.

In the ordinary course of business we may occasionally enter into agreements pursuant to which we may be obligated to pay for the failure of performance of others, such as the use of corporate credit cards issued to employees. Based on historical experience, we believe that the risk of sustaining any material loss related to such guarantees is remote.

We have entered into a number of agreements, including our agreements with commercial airlines, pursuant to which we indemnify the other party for losses and expenses suffered or incurred in connection with any patent, copyright, or trademark infringement or misappropriation claim asserted by a third party with respect to our equipment or services. The maximum potential amount of future payments we could be required to make under these indemnification agreements is uncertain and is typically not limited by the terms of the agreements.

Berkson Litigation - On February 25, 2014, Adam Berkson filed suit against us in the United States District Court for the Eastern District of New York, on behalf of putative classes of national purchasers and a subclass of New York purchasers of our connectivity service, alleging claims that we violated New York and other consumer protection laws, as well as an implied covenant of good faith and fair dealing, by misleading consumers about recurring charges for our service. The suit seeks unspecified damages. We have not accrued any liability related to this matter due to the early stage of the litigation and the difficulty of predicting the outcome. Based on currently available information, we believe we have strong defenses and intend to defend this lawsuit vigorously, but the outcome of this matter is inherently uncertain and may have a material adverse effect on our financial position, results of operations and cash flows.

12. Fair Value of Financial Assets and Liabilities

A three-tier fair value hierarchy has been established which prioritizes the inputs used in measuring fair value. These tiers include:

Level 1 - defined as observable inputs such as quoted prices in active markets;

Level 2 - defined as observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 - defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Long-Term Debt:

Our financial assets and liabilities that are disclosed but not measured at fair value include the Convertible Notes, Amended and Restated Senior Term Facility and the Alaska Facility (each as defined in Note 8, Long-Term Debt and Other Liabilities), all of which are reflected on the consolidated balance sheet at cost. The fair value of the Convertible Notes approximated the carrying value of $262.9 million as of March 31, 2015, as the debt was issued in March 2015. Based on market conditions, the fair value of the Amended and Restated Senior Term Facility was approximately $336 million and $339 million as of March 31, 2015 and December 31, 2014,

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respectively, with a carrying value of $306.7 million and $309.2 million as of March 31, 2015 and December 31, 2014, respectively. Based on market conditions, the fair value of the Alaska Facility approximated its carrying value of $0.9 million and $1.0 million as of March 31, 2015 and December 31, 2014, respectively. These fair value measurements are classified as Level 2 within the fair value hierarchy since they are determined based upon significant inputs observable in the market including interest rates on recent financings by entities with credit profiles similar to ours. We estimated the fair values of the Amended and Restated Senior Term Facility and the Alaska Facility by calculating the upfront cash payment a market participant would require to assume these obligations. The upfront cash payment, excluding any issuance costs, is the amount that a market participant would be able to lend at March 31, 2015 to an entity with a credit rating similar to ours and achieve sufficient cash inflows to cover the scheduled cash outflows under the Amended and Restated Senior Term Facility and the Alaska Facility.

13. Income Tax

The effective income tax rates for the three month periods ended March 31, 2015 and 2014 were (1.5%) and (1.6%), respectively. Income tax expense recorded in each period was similar, with differences in pre-tax income causing the change in the effective tax rate. The difference between our effective tax rates and the U.S. federal statutory rate of 35% for the three month periods ended March 31, 2015 and 2014 was primarily due to the recording of a valuation allowance against our net deferred tax assets which is excluded from taxable income (loss).

We are subject to taxation in the United States, Canada, Switzerland, Japan, Singapore, Mexico and various states. With few exceptions, as of March 31, 2015, we are no longer subject to U.S. federal, state, foreign or local examinations by tax authorities for years prior to 2011.

We record penalties and interest relating to uncertain tax positions in the income tax provision line item in the unaudited condensed consolidated statement of operations. No penalties or interest related to uncertain tax positions were recorded for the three month period ended March 31, 2015. As of March 31, 2015, we did not have a liability recorded for interest or potential penalties.

We do not expect there will be a change in the unrecognized tax benefits within the next 12 months.

In 2013 and 2014, the IRS issued final regulations that provide guidance with respect to (i) the treatment of material and supplies, (ii) capitalization of amounts paid to acquire or produce tangible property, (iii) the determination of whether an expenditure with respect to tangible property is a deductible repair or a capital expenditure and (iv) dispositions of MACRS property. The adoption of these final regulations did not have a material impact on our results of operations, financial position, or cash flows.

14. Business Segments and Major Customers

We operate our business through three operating segments: Commercial Aviation North America, or CA-NA , Commercial Aviation Rest of World, or CA-ROW and Business Aviation, or BA .

CA-NA Segment: Our CA-NA segment provides in-flight connectivity and wireless digital entertainment solutions to commercial airline passengers flying routes that generally begin and end within North America, which for this purpose includes the United States, Canada and Mexico.

CA-ROW Segment: Our CA-ROW business provides in-flight connectivity and wireless digital entertainment solutions to passengers flying on foreign-based commercial airlines and international flights of North American based commercial airlines, is in the start-up phase as we launched commercial international connectivity service in March 2014. The routes included in our CA-ROW segment are those that begin and/or end outside of North America (as defined above) for which our international service will be provided.

BA Segment: Our BA business provides equipment for in-flight connectivity along with voice and data services to the business aviation market. BA services include Gogo Biz, our in-flight broadband service that utilizes both our ATG network and our ATG spectrum, Gogo Vision, and satellite-based voice and data services through strategic alliances with satellite companies. Customers include business aircraft manufacturers, owners, and operators, as well as government and military entities.

The accounting policies of the operating segments are the same as those described in Note 2, Summary of Significant Accounting Policies . Intercompany transactions between segments are excluded as they are not included in management s performance review of the segments. We currently do not generate a material amount of foreign revenue. We do not segregate assets between segments for internal reporting. Therefore, asset-related information has not been presented. We do not disclose assets outside of the United States as we do not believe

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these assets are material as of March 31, 2015 and December 31, 2014. For our airborne assets, we consider only those assets installed in aircraft associated with international commercial airline partners to be owned outside of the United States.

Management evaluates performance and allocates resources to each segment based on segment profit (loss), which is calculated internally as net income (loss) attributable to common stock before interest expense, interest income, income taxes, depreciation and amortization, certain non-cash charges (including amortization of deferred airborne lease incentives and stock compensation expense) and other income (expense). Segment profit (loss) is a measure of performance reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segments and evaluating segment performance. In addition, segment profit (loss) is included herein in conformity with ASC 280-10, *Segment Reporting*. Management believes that segment profit (loss) provides useful information for analyzing and evaluating the underlying operating results of each segment. However, segment profit (loss) should not be considered in isolation or as a substitute for net income (loss) attributable to common stock or other measures of financial performance prepared in accordance with GAAP. Additionally, our computation of segment profit (loss) may not be comparable to other similarly titled measures computed by other companies.

Information regarding our reportable segments is as follows (*in thousands*):

	For the Three Months Ended March 31, 2015			
	CA-NA	**CA-ROW**	**BA**	**Total**
Service revenue	$ 72,178	$ 1,410	$ 21,818	$ 95,406
Equipment revenue	356		19,749	20,105
Total revenue	$ 72,534	$ 1,410	$ 41,567	$ 115,511
Segment profit (loss)	$ 9,616	$ (18,276)	$ 16,806	$ 8,146

	For the Three Months Ended March 31, 2014			
	CA-NA	**CA-ROW**	**BA**	**Total**
Service revenue	$ 56,435	$ 63	$ 15,793	$ 72,291
Equipment revenue	633		22,770	23,403
Total revenue	$ 57,068	$ 63	$ 38,563	$ 95,694
Segment profit (loss)	$ 5,804	$ (16,893)	$ 16,463	$ 5,374

A reconciliation of segment profit (loss) to the relevant consolidated amounts is as follows (*in thousands*):

	For the Three Months Ended March 31,	
	2015	**2014**
CA-NA segment profit	$ 9,616	$ 5,804
CA-ROW segment loss	(18,276)	(16,893)
BA segment profit	16,806	16,463
Total segment profit	8,146	5,374
Interest income	5	15
Interest expense	(10,095)	(7,248)
Depreciation and amortization	(18,777)	(15,687)
Amortization of deferred airborne lease incentives *(1)*	3,926	2,597
Stock compensation expense	(3,085)	(1,604)
Other income (expense)	82	(40)
Loss before income taxes	$ (19,798)	$ (16,593)

(1) Amortization of deferred airborne lease incentive relates to our CA-NA and CA-ROW segments. See Note 10, Leases for further information.

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Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Major Customers and Airline Partnerships During the three month periods ended March 31, 2015 and 2014, no customer accounted for more than 10% of our consolidated revenue. One airline partner for the CA-ROW segment accounted for approximately 17% and 18% of consolidated accounts receivable as of March 31, 2015 and December 31, 2014, respectively.

Revenue from passengers using the Gogo service while flying on aircraft by two of our airline partners accounted for approximately 41% and 39% of consolidated revenue for the three month periods ended March 31, 2015 and 2014, respectively.

15. Employee Retirement and Postretirement Benefits

Share-Based Compensation We have two share-based employee compensation plans as of March 31, 2015. See Note 11, Share-Based Compensation, in our 2014 10-K for further information regarding these plans. For the three month period ended March 31, 2015, options to purchase 104,045 shares of common stock were granted, options to purchase 87,370 shares of common stock were forfeited, options to purchase 11,924 shares of common stock expired, and options to purchase 241,586 shares of common stock were exercised.

For the three month period ended March 31, 2015, 34,148 restricted share units (RSUs) were granted, 4,728 RSUs vested and 20,930 RSUs expired.

For the three month period ended March 31, 2015, 8,389 deferred share units (DSUs) were granted.

For the three month period ended March 31, 2015, 4,171 shares of restricted stock were granted, which vest in equal annual increments over a four-year period. These shares are deemed issued as of the date of grant, but not outstanding until they vest.

The employee stock purchase plan (the ESPP) allows eligible employees to purchase our common stock through payroll deductions at a price equal to 90% of the lower of the fair market value of the stock as of the beginning or the end of three-month offering periods. Under the ESPP, 424,594 shares were reserved for issuance. The three month period ended March 31, 2015 reflects the issuance of 16,789 shares of common stock under the ESPP. The ESPP commenced in the third quarter of 2014.

Share-based compensation totaled $3.1 million and $1.6 million for the three month periods ended March 31, 2015 and 2014, respectively.

401(k) Plan Under our 401(k) plan, all employees who are eligible to participate are entitled to make tax-deferred contributions, subject to Internal Revenue Service limitations. We match 100% of the employee s first 4% of contributions made, subject to annual limitations. Our matching contributions were $1.0 million and $0.6 million for the three month periods ended March 31, 2015 and 2014, respectively.

16. Research and Development Costs

Expenditures for research and development are charged to expense as incurred and totaled $9.9 million and $8.4 million for the three month periods ended March 31, 2015 and 2014, respectively. Research and development costs are reported as a component of engineering, design and development expenses in our unaudited condensed consolidated statements of operations.

17. Canadian ATG Spectrum License

On July 17, 2012, Industry Canada issued to our Canadian subsidiary a subordinate license that allows us to use the Canadian ATG spectrum of which SkySurf Canada Communications Inc. (SkySurf) is the primary licensee. On July 24, 2012 we entered into a subordinate license agreement (the License Agreement) with SkySurf and on August 14, 2012 the agreement commenced. The License Agreement provides for our exclusive rights to use SkySurf s ATG spectrum licenses in Canada. The License Agreement has an initial term of ten years commencing on August 14, 2012 and, provided that the primary spectrum license agreement issued by Industry Canada to SkySurf remains in effect, is renewable at our option for an additional ten-year term following the initial expiration and thereafter for a further five-year term. We made a one-time payment of C$3.3 million, which was equivalent to approximately U.S. $3.3 million (one-time payment). The renewal of the primary spectrum license will depend upon the satisfaction by Gogo and SkySurf of certain conditions set forth in the license, including, without limitation, a network build-out requirement. The term of the License Agreement, including the initial ten-year term and any renewals, is contingent on the effectiveness and renewal of the primary spectrum license issued by Industry Canada to SkySurf on June 30, 2009, which expires on June 29, 2019. We pay SkySurf C$0.1 million, which is

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Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

equivalent to U.S. $0.1 million, monthly during the initial ten-year term of the License Agreement. Additionally, we make variable monthly payments based on the number of cell sites in Canada and the number of Canadian-domiciled commercial aircraft on which we provide our service.

As the License Agreement is for our exclusive use of a license, which is considered a right to use an intangible asset and thus not property, plant, or equipment, the agreement is not considered a lease for accounting purposes. As such, we recorded the SkySurf one-time payment as an asset in our unaudited condensed consolidated balance sheet at the time of payment. As of March 31, 2015, the one-time payment had balances of $0.1 million included in prepaid expenses and other current assets and $2.2 million included in other non-current assets, respectively, in our unaudited condensed consolidated balance sheet. The one-time payment is being amortized on a straight-line basis over the estimated term of the agreement of 25 years, which includes estimated renewal periods.

Amortization expense for the one-time payment for each of the next five years and thereafter is estimated to be as follows *(in thousands)*:

Years ending December 31,	Canadian ATG Spectrum Amortization	
2015 (period from April 1 to December 31)	$	79
2016	$	103
2017	$	103
2018	$	103
2019	$	103
Thereafter	$	1,811

Amortization expense totaled less than $0.1 million during the three month periods ended March 31, 2015 and 2014, respectively.

The monthly payments are expensed as incurred and totaled approximately $0.3 million and $0.2 million during the three month periods ended March 31, 2015 and 2014, respectively.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this report may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, without limitation, statements regarding our business outlook, industry, business strategy, plans, goals and expectations concerning our market position, international expansion, future technologies, future operations, margins, profitability, future efficiencies, capital expenditures, liquidity and capital resources and other financial and operating information. When used in this discussion, the words anticipate, assume, believe, budget, continue, could, estimate, expect, intend, potential, predict, project, should, will, future and the negative of these or similar terms and phrases are inten identify forward-looking statements in this Quarterly Report on Form 10-Q.

Forward-looking statements reflect our current expectations regarding future events, results or outcomes. These expectations may or may not be realized. Although we believe the expectations reflected in the forward-looking statements are reasonable, we can give you no assurance these expectations will prove to have been correct. Some of these expectations may be based upon assumptions, data or judgments that prove to be incorrect. Actual events, results and outcomes may differ materially from our expectations due to a variety of known and unknown risks, uncertainties and other factors. Although it is not possible to identify all of these risks and factors, they include, among others, the following:

- the loss of, or failure to realize benefits from, agreements with our airline partners or renew any existing agreements upon expiration or termination;
- any inability to timely and efficiently roll out our 2Ku service or other components of the technology roadmap for any reason, including regulatory delays, or the failure by our airline partners to roll out equipment upgrades, new services or adopt new technologies in order to support increased network capacity demands;
- the loss of relationships with original equipment manufacturers or dealers;
- our ability to develop network capacity sufficient to accommodate current and expected growth in passenger demand;
- unfavorable economic conditions in the airline industry and/or the economy as a whole;
- our ability to expand our international or domestic operations, including our ability to grow our business with current and potential future airline partners;
- an inability to compete effectively with other current or future providers of in-flight connectivity services and other products and services that we offer, including on the basis of price, service performance and line-fit availability;

our reliance on third-party satellite service providers and equipment and other suppliers, including single source providers and suppliers;

our ability to successfully develop and monetize new products and services such as Gogo Vision and Gogo Text & Talk, including those that were recently released, are currently being offered on a limited or trial basis, or are in various stages of development;

our ability to deliver products and services, including newly developed products and services, on schedules consistent with our contractual commitments to customers;

the effects, if any, on our business of past or future airline mergers, including the merger of American Airlines and U.S. Airways;

a revocation of, or reduction in, our right to use licensed spectrum, the availability of other air-to-ground spectrum to a competitor or the repurposing by a competitor of other spectrum for air-to-ground use;

our use of open source software and licenses;

the effects of service interruptions or delays, technology failures, material defects or errors in our software or damage to our equipment;

the limited operating history of our CA-NA and CA-ROW segments;

increases in our projected capital expenditures due to, among other things, unexpected costs incurred in connection with the roll-out of our technology roadmap or our international expansion;

compliance with U.S. and foreign government regulations and standards, including those related to regulation of the internet, including e-commerce or online video distribution changes, and the installation and operation of satellite equipment and our ability to obtain and maintain all necessary regulatory approvals to install and operate our equipment in the U.S. and foreign jurisdictions;

our, or our technology suppliers , inability to effectively innovate;

costs associated with defending pending or future intellectual property infringement and other litigation or claims;

our ability to protect our intellectual property;

any negative outcome or effects of pending or future litigation;

limitations and restrictions in the agreements governing our indebtedness and our ability to service our indebtedness;

our ability to obtain additional financing on acceptable terms or at all;

fluctuations in our operating results;

our ability to attract and retain customers and to capitalize on revenue from our platform;

the demand for and market acceptance of our products and services;

changes or developments in the regulations that apply to us, our business and our industry;

the attraction and retention of qualified employees including key personnel;

- the effectiveness of our marketing and advertising and our ability to maintain and enhance our brands;

- our ability to manage our growth in a cost-effective manner and integrate and manage acquisitions;

- compliance with anti-corruption laws and regulations in the jurisdictions in which we operate, including the Foreign Corrupt Practices Act and the (U.K.) Bribery Act 2010;

- restrictions on the ability of U.S. companies to do business in foreign countries, including, among others, restrictions imposed by the U.S. Office of Foreign Assets Control;

- difficulties in collecting accounts receivable; and

- other risks and factors listed under Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2014 as filed with the Securities Exchange Commission (SEC) on February 27, 2015 (the 2014 10-K).

Any one of these factors or a combination of these factors could materially affect our financial condition or future results of operations and could influence whether any forward-looking statements contained in this report ultimately prove to be accurate. Our forward-looking statements are not guarantees of future performance, and you should not place undue reliance on them. All forward-looking statements speak only as of the date made and we undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

In addition, while we do, from time to time, communicate with security analysts, it is against our policy to disclose to them any material non-public information or other confidential information. Accordingly, stockholders should not assume that we agree with any statement or report issued by any analyst irrespective of the content of the statement or report. Thus, to the extent that reports issued by securities analysts contain any projections, forecasts, or opinions, such reports are not our responsibility.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is intended to help the reader understand our business, financial condition, results of operations, liquidity and capital resources. You should read this discussion in conjunction with our unaudited condensed consolidated interim financial statements and the related notes contained elsewhere in this Quarterly Report on Form 10-Q. Unless the context otherwise indicates or requires, the terms we, our, us, Gogo, and the Company, as used in this report, refer to Gogo Inc. and its directly and indirectly owned subsidiaries as a combined entity, except where otherwise stated or where it is clear that the terms refer only to Gogo Inc. exclusive of its subsidiaries.

The statements in this discussion regarding industry outlook, our expectations regarding our future performance, liquidity and capital resources and other non-historical statements in this discussion are forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described under Risk Factors in the 2014 10-K and in Special Note Regarding Forward-Looking Statements in this report. Our actual results may differ materially from those contained in or implied by any forward-looking statements.

Our fiscal year ends December 31 and, unless otherwise noted, references to years or fiscal are for fiscal years ended December 31. See Results of Operations.

Company Overview

Gogo (we , us , our) is a leading global aero communications service provider for the global aviation industry. We operate through the following three segments: Commercial Aviation North America, or CA-NA, Commercial Aviation Rest of World, or CA-ROW, and Business Aviation, or BA.

Services provided by our CA-NA and CA-ROW businesses include Gogo Connectivity, which allows passengers to connect to the internet from their personal Wi-Fi-enabled devices, Gogo Vision, which offers passengers the opportunity to enjoy a broad selection of in-flight entertainment options on their personal Wi-Fi enabled devices, and other service revenue, which include a broad range of customizable, targeted content, advertising and e-commerce services. Services are provided by the CA-NA business on commercial aircraft flying routes that generally begin and end within North America, which for this purpose includes the United States, Canada and Mexico. Our CA-ROW business, which is in the start-up phase as we launched commercial international service in March 2014, provides service on commercial aircraft operated by foreign-based commercial airlines and international flights of North American based commercial airlines. The routes included in our CA-ROW segment are those that begin and/or end outside of North America (as defined above) for which our international service is provided. Our BA business provides in-flight internet connectivity and other voice and data communications products and services and sells equipment for in-flight telecommunications to the business aviation market. BA services include Gogo Biz, our in-flight broadband service which utilizes our ATG network and spectrum, Gogo Vision, and satellite-based voice and data services through our strategic alliances with satellite companies.

Recent Developments

Convertible Notes On March 3, 2015, we issued $340.0 million aggregate principal amount of 3.75% Convertible Senior Notes due 2020 (the Convertible Notes) in a private offering to qualified institutional buyers, pursuant to Rule 144A under the Securities Act of 1933, as amended. We granted an option to the initial purchasers to purchase up to an additional $60.0 million aggregate principal amount of Convertible Notes to cover over-allotments, of which $21.9 million was subsequently exercised during March 2015, resulting in a total issuance of $361.9 million aggregate principal amount of Convertible Notes. See Note 8, Long-Term Debt and Other Liabilities in our unaudited condensed consolidated financial statements for additional information regarding the Convertible Notes.

In connection with the issuance of the Convertible Notes, we paid approximately $140 million to enter into prepaid forward stock repurchase transactions (the Forward Transactions) with certain financial institutions, (the Forward Counterparties), pursuant to which we purchased approximately 7.2 million shares of common stock for settlement on or around the March 1, 2020 maturity date for the Convertible Notes, subject to the ability of each Forward Counterparty to elect to settle all or a portion of its Forward Transactions early. See Note 8, Long-Term Debt and Other Liabilities in our unaudited condensed consolidated financial statements for additional information regarding the Forward Transactions.

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Delta Air Lines In May 2015, Delta Air Lines and Gogo entered into a definitive agreement under which Gogo will provide 2Ku service on 250 of Delta s existing mainline domestic aircraft and at least 25 new international aircraft when they enter Delta s fleet.

United Airlines In March 2015, we entered into a definitive agreement with United Airlines pursuant under which our equipment will be installed and our in-flight connectivity and Gogo Vision services will be provided on what we estimate will be approximately 220 United regional jets.

Factors and Trends Affecting Our Results of Operations

We believe that our operating and business performance is driven by various factors that affect the commercial airline and business aviation industries, including trends affecting the travel industry and trends affecting the customer bases that we target, as well as factors that affect wireless internet service providers and general macroeconomic factors. Key factors that may affect our future performance include:

- costs associated with implementing, and our ability to implement on a timely basis, our technology roadmap, including the need for additional cell sites in our ATG network, upgrades and installation of our ATG-4 technology, the roll-out of our satellite services, the potential licensing of additional spectrum, the development and implementation of 2Ku and other new technologies and the implementation of improvements to our network and operations as technology changes and we experience increased network capacity constraints;

- costs associated with and our ability to execute our international expansion, including modification to our network to accommodate satellite technology, development and implementation of new satellite-based technologies, the availability and cost of satellite capacity and compliance with applicable foreign regulations and expanded operations outside of the U.S.;

- costs associated with managing a rapidly growing company;

- the pace and extent of adoption of the Gogo service for use on international commercial aircraft by our current North American airline partners and new international airline partners;

- the number of aircraft in service in our markets, including consolidation of the airline industry or changes in fleet size by one or more of our commercial airline partners or BA fractional ownership customers;

- economic environment and other trends that affect both business and leisure travel;

- the extent of passengers , airline partners and other aircraft owners and operators adoption of our products and services, which is affected by, among other things, willingness to pay for the services that we provide, changes in technology and competition from current competitors and new market entrants;

continued demand for connectivity and proliferation of Wi-Fi enabled devices, including smartphones, tablets and laptops;

changes in laws, regulations, and interpretations affecting telecommunications services, including those affecting our ability to maintain our licenses for ATG spectrum in the U.S., obtain sufficient rights to use additional ATG spectrum and/or other sources of broadband connectivity to deliver our services, and expand our service offerings;

changes in laws, regulations and interpretations affecting aviation, including in particular changes that impact the design of our equipment and our ability to obtain required certifications for our equipment; and

our ability to obtain required foreign telecommunications, aviation and other licenses and approvals necessary for our international operations.

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Summary Financial Information

Consolidated revenue was $115.5 million and $95.7 million for the three month periods ended March 31, 2015 and 2014, respectively. As of March 31, 2015, the CA-NA segment had 2,200 commercial aircraft online to provide the Gogo service as compared with 2,056 as of March 31, 2014. As of March 31, 2015, the BA segment had 5,353 aircraft online with Iridium satellite communications systems and 2,983 Gogo Biz systems online as compared with 5,236 and 2,250, respectively, as of March 31, 2014. The BA segment became a reseller of Inmarsat SwiftBroadband satellite service in 2013 and had 49 systems online as of March 31, 2015 as compared with 16 systems online as of March 31, 2014. As of March 31, 2015, the CA-ROW segment had 116 commercial aircraft online as compared with five aircraft as of March 31, 2014.

Key Business Metrics

Our management regularly reviews a number of financial and operating metrics, including the following key operating metrics for the CA-NA and BA segments, to evaluate the performance of our business and our success in executing our business plan, make decisions regarding resource allocation and corporate strategies and evaluate forward-looking projections.

Commercial Aviation North America

	For the Three Months Ended March 31,	
	2015	2014
Aircraft online	2,200	2,056
Average monthly service revenue per aircraft online (ARPA)	$ 11,194	$ 9,199
Gross passenger opportunity (GPO) (in thousands)	74,384	71,270
Total average revenue per passenger opportunity (ARPP)	$ 0.97	$ 0.79
Total average revenue per session (ARPS)	$ 11.73	$ 10.55
Connectivity take rate	7.2%	7.2%

Aircraft online. We define aircraft online as the total number of commercial aircraft on which our ATG network equipment is installed and Gogo service has been made commercially available as of the last day of each period presented.

Average monthly service revenue per aircraft online (ARPA). We define ARPA as the aggregate service revenue for the period divided by the number of months in the period, divided by the number of aircraft online during the period (expressed as an average of the month end figures for each month in such period).

Gross passenger opportunity (GPO). We define GPO as the aggregate number of passengers who board commercial aircraft on which Gogo service has been available during the period presented. When available directly from airline partners, we aggregate actual passenger counts across flights on Gogo-equipped aircraft.

When not available directly from our airline partners, we estimate GPO. Estimated GPO is calculated by first estimating the number of flights occurring on each Gogo-equipped aircraft, then multiplying by the number seats on that aircraft, and finally multiplying by a seat factor that is determined from historical information provided to us in arrears by our airline partners. The estimated number of flights are derived from real-time flight information provided to our front-end systems by Air Radio Inc. (ARINC), direct airline feeds, and supplementary third-party data sources. These aircraft-level estimates are then aggregated with actual airline-provided passenger counts to obtain total GPO.

Total average revenue per passenger opportunity (ARPP). We define ARPP as revenue from Gogo Connectivity, Gogo Vision, and other service revenue for the period, divided by GPO for the period.

Total average revenue per session (ARPS). We define ARPS as revenue from Gogo Connectivity, excluding non-session related revenue, divided by the total number of sessions during the period. A session, or a use of Gogo Connectivity, is defined as the use by a unique passenger of Gogo Connectivity on a flight segment. Multiple logins or purchases under the same user name during one flight segment count as only one session.

Connectivity take rate. We define connectivity take rate as the number of sessions during the period expressed as a percentage of GPO. Included in our connectivity take-rate calculation are sessions for which we did not receive revenue, including those provided pursuant to free promotional campaigns and, to a lesser extent, as a result of complimentary passes distributed by our customer service representatives or unforeseen technical issues. For the periods listed above, the number of sessions for which we did not receive revenue was not material.

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Business Aviation

	For the Three Months Ended March 31, 2015	2014
Aircraft online		
Satellite	5,402	5,252
ATG	2,983	2,250
Average monthly service revenue per aircraft online		
Satellite	$ 169	$ 160
ATG	2,169	2,006
Units Shipped		
Satellite	143	153
ATG	234	241
Average equipment revenue per unit shipped (in thousands)		
Satellite	$ 39	$ 48
ATG	55	64

Satellite aircraft online. We define satellite aircraft online as the total number of business aircraft for which we provide satellite services in operation as of the last day of each period presented.

ATG aircraft online. We define ATG aircraft online as the total number of business aircraft for which we provide ATG services in operation as of the last day of each period presented.

Average monthly service revenue per satellite aircraft online. We define average monthly service revenue per satellite aircraft online as the aggregate satellite service revenue for the period divided by the number of months in the period, divided by the number of satellite aircraft online during the period (expressed as an average of the month end figures for each month in such period).

Average monthly service revenue per ATG aircraft online. We define average monthly service revenue per ATG aircraft online as the aggregate ATG service revenue for the period divided by the number of months in the period, divided by the number of ATG aircraft online during the period (expressed as an average of the month end figures for each month in such period).

Units shipped. We define units shipped as the number of satellite or ATG network equipment units, respectively, shipped during the period.

Average equipment revenue per satellite unit shipped. We define average equipment revenue per satellite unit shipped as the aggregate equipment revenue earned from all satellite shipments during the period, divided by the number of satellite units shipped.

Average equipment revenue per ATG unit shipped. We define average equipment revenue per ATG unit shipped as the aggregate equipment revenue from all ATG shipments during the period, divided by the number of ATG units shipped.

Key Components of Consolidated Statements of Operations

There have been no material changes to our key components of consolidated statements of operations and segment profit (loss) as described in Management s Discussion and Analysis of Financial Condition and Results of Operations in our 2014 10-K.

Off-Balance Sheet Arrangements

We do not have any obligations that meet the definition of an off-balance sheet arrangement, other than operating leases, which have or are reasonably likely to have a material effect on our results of operations. See Note 10, Leases to our unaudited condensed consolidated financial statements for further information.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of our unaudited condensed consolidated financial statements and related disclosures require us to make estimates, assumptions and judgments that affect the reported amount of assets, liabilities, revenue, costs and expenses, and related exposures. We base our estimates and assumptions on historical experience and other factors that we believe to be reasonable under the circumstances. In some instances, we could reasonably use different accounting estimates, and in some instances results could differ significantly from our estimates. We evaluate our estimates and assumptions on an ongoing basis. To the extent that there are differences between our estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

We believe that the assumptions and estimates associated with long-lived assets, indefinite-lived assets and share-based compensation have the greatest potential impact on our unaudited condensed consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates.

There have been no material changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates described in Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) in our 2014 10-K.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue From Contracts With Customers* (ASU 2014-09). This pronouncement outlines a single comprehensive model to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The core principle of ASU 2014-09 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. As originally proposed, this guidance was effective for annual reporting periods beginning on or after December 15, 2016, including interim periods within that reporting period, and early adoption was not permitted. In April 2015, the FASB voted to propose to defer the effective date by one year, to annual reporting periods beginning on or after December 15, 2017, including interim periods within that reporting period. The FASB also voted to permit early adoption of the guidance, but no earlier than the original effective date. We will adopt this guidance as of January 1, 2018. We are currently evaluating the impact of the adoption of this guidance on our financial position, results of operations and cash flows.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern* (ASU 2014-15). This pronouncement provides additional guidance surrounding the disclosure of going concern uncertainties in the financial statements requires that management perform interim and annual assessments of an entity s ability to continue as a going concern within one year of the date the financial statements are issued. We will adopt this guidance as of January 1, 2017. We do not anticipate that the adoption of this guidance will result in additional disclosures.

In April 2015, the FASB issued ASU 2015-03, *Interest Imputation of Interest (Subtopic 835-30)* (ASU 2015-03), which requires that debt issuance costs be presented in the balance sheets as a direct deduction from the carrying amount of the related debt liability. The new requirement is effective for fiscal years beginning on or after December 15, 2015, and for interim periods within those fiscal years. Retrospective presentation is required for all comparable periods presented. We do not believe that the adoption of this guidance will have a material impact on our consolidated financial statements.

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Results of Operations

The following table sets forth, for the periods presented, certain data from our unaudited condensed consolidated statements of operations. The information contained in the table below should be read in conjunction with our unaudited condensed consolidated financial statements and related notes.

Unaudited Condensed Consolidated Statement of Operations Data

(in thousands)

	For the Three Months Ended March 31, 2015	2014
Revenue:		
Service revenue	$ 95,406	$ 72,291
Equipment revenue	20,105	23,403
Total revenue	115,511	95,694
Operating expenses:		
Cost of service revenue (exclusive of items shown below)	45,547	39,628
Cost of equipment revenue (exclusive of items shown below)	9,458	9,986
Engineering, design and development	17,085	14,099
Sales and marketing	10,241	8,042
General and administrative	24,193	17,572
Depreciation and amortization	18,777	15,687
Total operating expenses	125,301	105,014
Operating loss	(9,790)	(9,320)
Other (income) expense:		
Interest income	(5)	(15)
Interest expense	10,095	7,248
Other (income) expense	(82)	40
Total other expense	10,008	7,273
Loss before incomes taxes	(19,798)	(16,593)
Income tax provision	294	273
Net loss	$ (20,092)	$ (16,866)

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Three Months Ended March 31, 2015 and 2014

Revenue:

Revenue by segment and percent change for the three month periods ended March 31, 2015 and 2014 were as follows *(in thousands, except for percent change)*:

	For the Three Months Ended March 31, 2015	2014	% Change 2015 over 2014
Service Revenue:			
CA-NA	$ 72,178	$ 56,435	27.9%
BA	21,818	15,793	38.1%
CA-ROW	1,410	63	2,138.1%
Total Service Revenue	$ 95,406	$ 72,291	32.0%
Equipment Revenue:			
CA-NA	$ 356	$ 633	(43.8%)
BA	19,749	22,770	(13.3%)
CA-ROW			na
Total Equipment Revenue	$ 20,105	$ 23,403	(14.1%)
Total Revenue:			
CA-NA	$ 72,534	$ 57,068	27.1%
BA	41,567	38,563	7.8%
CA-ROW	1,410	63	2,138.1%
Total Revenue	$ 115,511	$ 95,694	20.7%

Commercial Aviation North America:

CA-NA revenue increased 27.1% to $72.5 million from $57.1 million for the three month periods ended March 31, 2015 and 2014, respectively, primarily due to an increase in connectivity service revenue. Gogo Connectivity sessions totaled 5.4 million in the three month period ended March 31, 2015 as compared with 5.1 million in the prior year period. The increase in CA-NA connectivity service revenue was primarily due to increases in ARPS, which resulted in increases in ARPA and ARPP. ARPS increased to $11.73 for the three month period ended March 31, 2015 as compared with $10.55 for the prior year period due primarily to changes in pricing and product mix. ARPA increased to $11,194 for the three month period ended March 31, 2015 as compared with $9,199 for the prior year period. ARPP increased to $0.97 for the three month period ended March 31, 2015 as compared with $0.79 for the prior year period. GPO increased to 74.4 million for the three month period ended March 31, 2015 as compared with 71.3 million for the prior year period, driven by an increase in aircraft online. The connectivity take rate remained flat at 7.2% for the three month periods ended March 31, 2015 and 2014 as the three months ended March 31, 2014 included a large sponsorship.

CA-NA retail revenue increased to $59.7 million for the three month period ended March 31, 2015 as compared with $51.2 million for the prior year period, due to growth in both individual sessions and subscriptions. Revenue from individual sessions increased to $37.7 million for the three month period ended March 31, 2015 as compared with $29.9 million for the prior year period, and revenue from subscriptions increased to $22.0 million for the three month period ended March 31, 2015 as compared with $21.3 million for the prior year period. These revenue increases were due to price changes and increased passenger adoption of the Gogo service. Our non-retail revenue increased to $5.2 million for the three month period ended March 31, 2015 as compared with $3.0 million for the prior year period primarily due to increases in roaming and wholesale revenue, offset in part by a decrease in sponsorship revenue.

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A summary of the components of CA-NA s service revenue for the three month periods ended March 31, 2015 and 2014 is as follows *(in thousands, except for percent change)*:

	For the Three Months Ended March 31, 2015	2014	% Change 2015 over 2014
Gogo Connectivity revenue(1)	$ 64,897	$ 54,212	19.7%
Gogo Vision and other service revenue (2)	7,281	2,223	227.5%
Total service revenue	$ 72,178	$ 56,435	27.9%

(1) Includes non-session related revenue of $2.0 million for the three month period ended March 31, 2015.
(2) Other service revenue includes content filtering, VoIP access for airlines flight crews, portal development services, operations-oriented communications services, third-party advertising, e-commerce revenue share arrangements and partner co-branding and reseller arrangements.

The increase in Gogo Vision and other service revenue of 227.5% to $7.3 million for the three month period ended March 31, 2015 as compared with $2.2 million for the prior year period was driven by the commencement of a business-to-business arrangement with one of our airline partners for our Gogo Vision offering (which commenced in the second half of 2014), a second Gogo Vision program that commenced in the first half of 2015 with one of our airline partners, and to a lesser extent, the increase in revenues from partner co-branding and reseller arrangements and operations oriented communications services, offset in part by a decrease in other service revenues.

Business Aviation:

BA revenue increased 7.8% to $41.6 million for the three month period ended March 31, 2015 as compared with $38.6 million for the prior year period, due to an increase in service revenue, partially offset by a decrease in equipment revenue. BA service revenue increased 38.1% to $21.8 million for the three month period ended March 31, 2015 as compared with $15.8 million for the prior year period, primarily due to more customers subscribing to our Gogo Biz (ATG) service as well as price increases implemented during 2014. The number of ATG aircraft online increased 32.6% to 2,983 as of March 31, 2015 as compared with 2,250 as of March 31, 2014.

BA equipment revenue decreased to $19.7 million for the three month period ended March 31, 2015 as compared with $22.8 million for the prior year period due to decreases in ATG and satellite equipment revenues partially offset by an increase in Universal Cabin System equipment revenue. ATG equipment revenue decreased 16.4% to $12.8 million for the three month period ended March 31, 2015, as compared with $15.3 million for the prior year period, due to a product mix shift to lower priced systems and a 2.9% decrease in the overall number of ATG equipment units shipped in the period.

Commercial Aviation Rest of World:

Our CA-ROW segment is in the start-up phase. We generated $1.4 million of service revenue during the three month period ended March 31, 2015 as compared with $0.1 million in the prior year period. Our CA-ROW in-flight connectivity service commenced in March 2014.

Cost of Service Revenue:

Cost of service revenue by segment and percent change for the three month periods ended March 31, 2015 and 2014 were as follows *(in thousands, except for percent change)*:

	For the Three Months Ended March 31, 2015	2014	% Change 2015 over 2014
CA-NA	$ 31,539	$ 27,223	15.9%
BA	5,804	4,649	24.8%
CA-ROW	8,204	7,756	5.8%
Total	$ 45,547	$ 39,628	14.9%

CA-NA cost of service revenue increased to $31.5 million for the three month period ended March 31, 2015 as compared with $27.2 million for the prior year period, due to an increase in revenue share earned by our airline partners, an increase in content costs related to our Gogo Vision service offerings and an increase in network

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operations expenses (including network maintenance, backhaul and site leases). The revenue share increase of $1.9 million for the three month period ended March 31, 2015 over the prior year period was primarily driven by the increase in CA-NA service revenue for the current year. We also had increases in billing and transaction related expenses as a result of an increase in the number of Gogo Connectivity sessions. These increases were partially offset by an increase in the amortization of our deferred airborne lease incentives. See Note 10, Leases in our unaudited condensed consolidated financial statements for additional information regarding our deferred airborne lease incentives.

BA cost of service revenue increased to $5.8 million for the three month period ended March 31, 2015 as compared with $4.6 million for the prior year period. The increase in cost of service revenue was primarily due to the year-over-year increase in the number of ATG units online and an increase in the average network utilization per ATG unit online, which resulted in higher ATG network service costs. Our satellite service fees also increased for the three month period ended March 31, 2015 as compared with the prior year period due to an increase in the number of subscribers of our satellite services to 5,353 as of March 31, 2015 from 5,252 as of March 31, 2014 including the higher cost to provide SwiftBroadband service.

CA-ROW cost of service revenue increased to $8.2 million for the three month period ended March 31, 2015 as compared with $7.8 million in the prior year period due to additional satellite service fees and revenue share expense and billing and transaction related expenses as we commenced service in March 2014. These increases were partially offset by the amortization of our deferred airborne lease incentives. See Note 10, Leases in our consolidated financial statements for additional information regarding our deferred airborne lease incentives.

We expect cost of service revenue for CA-NA to increase in future periods due to increases in revenue share and transaction expenses as our service revenue continues to increase. We believe that our network related expenses will increase to support the projected increased use and expansion of our network, which will include additional satellite coverage to support and/or supplement service in certain geographical areas. Additionally, we expect our maintenance costs to increase in future periods. However, a significant portion of our ATG network operations costs is relatively fixed in nature and does not fluctuate directly with revenue. As such, we expect total cost of service revenue in CA-NA to decline as a percentage of total service revenue as we realize efficiencies inherent in the scalability of our business.

As we expand our business internationally, we also expect to incur additional cost of service revenue in CA-ROW, reflecting increased satellite usage and additional revenue share, billing, transaction and network related expenses.

Cost of Equipment Revenue:

Cost of equipment revenue by segment and percent change for the three month period ended March 31, 2015 and 2014 were as follows *(in thousands, except for percent change)*:

	For the Three Months Ended March 31, 2015	For the Three Months Ended March 31, 2014	% Change 2015 over 2014
CA-NA	$ 151	$ 987	(84.7%)
BA	9,307	8,999	3.4%
CA-ROW			na

Total	$ 9,458	$ 9,986	(5.3%)

Cost of equipment revenue decreased to $9.5 million for the three month period ended March 31, 2015 as compared with $10.0 million for the prior year period. The decrease occurred primarily within the CA-NA segment due to a decrease in equipment related activities offset in part by increases in the BA segment due to shifts in product mix and an increase in warranty reserve due to additional units outstanding and claims experience. We expect that our cost of equipment revenue will vary with changes in equipment revenue.

Engineering, Design and Development Expenses:

Engineering, design and development expenses increased 21.2% to $17.1 million for the three month period ended March 31, 2015 as compared with $14.1 million for the prior year period, due primarily to an increase in the CA-NA and BA segments. Engineering, design and development expenses for the CA-NA segment increased 43.3% for the three month period ended March 31, 2015 as compared with the prior year period due to higher

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personnel expenses in connection with the development of next generation products and technologies and, to a lesser extent, Supplemental Type Certificates (STCs). Engineering, design and development expenses for the BA segment increased 15.9% for the three month period ended March 31, 2015 as compared with the prior year period due to higher personnel expenses in connection with the development of next generation products, technologies and certifications.

We expect engineering, design and development expenses to increase in future periods as we continue to execute our technology roadmap, expand internationally and develop next generation products and technologies.

Sales and Marketing Expenses:

Sales and marketing expenses increased 27.3% to $10.2 million for the three month period ended March 31, 2015 as compared with $8.0 million for the prior year period, due to increases in all three segments. Consolidated sales and marketing expenses as a percentage of total consolidated revenue increased to 8.9% for the three month period ended March 31, 2015 as compared with 8.4% for the prior year period. Sales and marketing expenses for the CA-ROW segment increased 65.1% for the three month period ended March 31, 2015 over the prior year period due to increased customer care efforts in connection with the commercial launch of international service and building our international sales and marketing teams. Sales and marketing expenses in the CA-NA segment increased 18.1% for the three month period ended March 31, 2015 over the prior year period due to an increase in personnel expense to support the growth of the business and marketing related activities. Sales and marketing expenses in the BA segment increased 16.8% for the three month period ended March 31, 2015 over the prior year period due to an increase in personnel expense to support the growth of the business and new product launches.

We expect our sales and marketing expenses to increase in future periods as we increase advertising and promotional initiatives for new product offerings, commence our service on aircraft operated by new airline partners both in CA-NA and CA-ROW, and expand programs to retain and support our existing users. In addition, the commission component of sales and marketing expenses at BA will fluctuate with its equipment revenue. We expect consolidated sales and marketing expenses to remain relatively flat as a percentage of consolidated revenue in the near-term as we launch new airline partnerships but to decrease as a percentage of consolidated revenue in the long-term.

General and Administrative Expenses:

General and administrative expenses increased 37.7% to $24.2 million for the three month period ended March 31, 2015 as compared with $17.6 million for the prior year period due to increases in all three segments. Consolidated general and administrative expenses as a percentage of total consolidated revenue increased to 20.9% for the three month period ended March 31, 2015 from 18.4% for the prior year period.

The increase in the CA-NA segment s general and administrative expenses of 43.8% for the three month period ended March 31, 2015 over the prior year period was due primarily to an increase in personnel related expenses (including bonus and share-based compensation expense, both of which are included in general and administrative expenses for all of CA-NA s employees), an increase in rent expense as we leased new office facilities (including the impact of overlapping leases for part of the year) and an increase in contract labor.

The increase in the CA-ROW segment s general and administrative expenses of 33.0% for the three month period ended March 31, 2015 over the prior year period was due primarily to an increase in personnel, travel and rent, all of which resulted from a ramp up in CA-ROW activities as we continued our international expansion.

The increase in the BA segment s general and administrative expenses of 18.3% for the three month period ended March 31, 2015 over the prior year period was due primarily to an increase in personnel related expenses (including share-based compensation expense, which is included in general and administrative expense for all of BA s employees) to manage the growth of the business and an increase in rent expense as we leased new office facilities (including the impact of overlapping leases for part of the year), offset in part by a decrease in legal expenses.

We expect our general and administrative expenses to increase in future periods as we expand our workforce to support the growth of our business both domestically and internationally. However, we expect general and administrative expenses to decrease as a percentage of consolidated revenue.

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Segment Profit (Loss):

CA-NA s segment profit increased 65.7% to $9.6 million for the three month period ended March 31, 2015 as compared with $5.8 million for the prior year period. The increase in CA-NA s segment profit for the three month period ended March 31, 2015 was due to increases in service revenue partially offset by increases in operating expenses, as discussed above.

BA s segment profit increased 2.1% to $16.8 million for the three month period ended March 31, 2015 as compared with $16.5 million for the prior year period. The increase in BA s segment profit for the three month period ended March 31, 2015 was due to increases in service revenue, partially offset by increases in operating expenses and a decrease in equipment revenue, as discussed above.

CA-ROW s segment loss increased 8.2% to $18.3 million for the three month period ended March 31, 2015 as compared with $16.9 million for the prior year period due to CA-ROW being in the start-up phase and our continued investment in this segment. The increase in CA-ROW s segment loss was due primarily to increases in operating expenses, partially offset by an increase in service revenue, as discussed above.

Depreciation and Amortization:

Depreciation and amortization expense increased 19.7% to $18.8 million for the three month period ended March 31, 2015 as compared with $15.7 million for the prior year period. The increase in depreciation and amortization expense was due to the increase in the number of aircraft outfitted with our airborne equipment by our CA-ROW and CA-NA segments, along with leasehold improvements and furniture and fixtures associated with our new office facilities.

We expect our depreciation and amortization expense to increase in future periods as we install our equipment on additional aircraft, install more expensive satellite-based equipment on aircraft (primarily to service the CA-ROW segment), further expand our network, and complete the build out of our new Chicago, IL office facility.

Other (Income) Expense:

Other (income) expense and percent change for the three month periods ended March 31, 2015 and 2014 were as follows *(in thousands, except for percent change)*:

	For the Three Months Ended March 31,		**% Change 2015 over**
	2015	**2014**	**2014**
Interest income	$ (5)	$ (15)	(66.7%)
Interest expense	10,095	7,248	39.3%
Other income	(82)	40	na
Total	$ 10,008	$ 7,273	37.6%

Other expense was $10.0 million for the three month period ended March 31, 2015 as compared with $7.3 million for the prior year period. The increase in interest expense during the three month period ended March 31, 2015 versus the prior year period was due to higher average debt levels outstanding during the current year as compared with the prior year as a result of the amendment to the Senior Term Facility that we entered into on July 30, 2014 and the issuance of the Convertible Notes in March 2015.

We expect our interest expense to increase in 2015 due to higher average debt outstanding in 2015 than in 2014 as a result of the amendment to the Senior Term Facility that we entered into on July 30, 2014 and the impact of issuance of the Convertible Notes in March 2015. See Note 8, Long-Term Debt and Other Liabilities, in our unaudited condensed consolidated financial statements for additional information. Interest expense will also increase due to amortization of additional deferred financing costs.

Income Taxes:

The effective income tax rate for the three month period ended March 31, 2015 was (1.5%) as compared with (1.6%) for the prior year period. Income tax expense recorded in each period was similar, with differences in pre-tax income causing the change in the effective tax rate. The difference between our effective tax rates and the U.S. federal statutory rate of 35% for the three month periods ended March 31, 2015 and 2014 was primarily due to the recording of a valuation allowance against our net deferred tax assets which is excluded from taxable income (loss).

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We expect our income tax provision to increase in future periods to the extent we become profitable.

Non-GAAP Measures

In our discussion below, we discuss certain non-GAAP financial measurements, including Adjusted EBITDA, Adjusted Net Loss Per Share and Cash CAPEX as defined below. Management uses Adjusted EBITDA and Cash CAPEX for business planning purposes, including managing our business against internally projected results of operations and measuring our performance and liquidity. Management prepares Adjusted Net Loss Per Share for investors, securities analysts and other users of our financial statements for use in evaluating our performance under our current capital structure. These supplemental performance measures also provide another basis for comparing period to period results by excluding potential differences caused by non-operational and unusual or non-recurring items. These supplemental performance measurements may vary from and may not be comparable to similarly titled measures by other companies. Adjusted EBITDA, Adjusted Net Loss Per Share and Cash CAPEX are not recognized measurements under accounting principles generally accepted in the United States, or GAAP, and when analyzing our performance or liquidity, as applicable, investors should (i) evaluate each adjustment in our reconciliation to net loss attributable to common stock, and the explanatory footnotes regarding those adjustments, (ii) use Adjusted EBITDA and Adjusted Net Loss Per Share in addition to, and not as an alternative to, net loss attributable to common stock as a measure of operating results, and (iii) use Cash CAPEX in addition to, and not as an alternative to, consolidated capital expenditures when evaluating our liquidity.

Definition and Reconciliation of Non-GAAP Measures

EBITDA represents net income (loss) attributable to common stock before income taxes, interest income, interest expense, depreciation expense and amortization of other intangible assets.

Adjusted EBITDA represents EBITDA adjusted for (i) stock-based compensation expense and (ii) amortization of deferred airborne lease incentives. Our management believes that the use of Adjusted EBITDA eliminates items that, management believes, have less bearing on our operating performance, thereby highlighting trends in our core business which may not otherwise be apparent. It also provides an assessment of controllable expenses, which are indicators management uses to determine whether current spending decisions need to be adjusted in order to meet financial goals and achieve optimal financial performance.

We believe the exclusion of stock-based compensation expense from Adjusted EBITDA is appropriate given the significant variation in expense that can result from using the Black-Scholes model to determine the fair value of such compensation. The fair value of our stock options as determined using the Black-Scholes model varies based on fluctuations in the assumptions used in this model, including inputs that are not necessarily directly related to the performance of our business, such as the expected volatility, the risk-free interest rate and the expected life of the options. Therefore, we believe the exclusion of this cost provides a clearer view of the operating performance of our business. Further, stock option grants made at a certain price and point in time do not necessarily reflect how our business is performing at any particular time. While we believe that investors should have information about any dilutive effect of outstanding options and the cost of that compensation, we also believe that stockholders should have the ability to consider our performance using a non-GAAP financial measure that excludes these costs and that management uses to evaluate our business.

We believe the exclusion of the amortization of deferred airborne lease incentives from Adjusted EBITDA is useful as it allows an investor to view operating performance across time periods in a manner consistent with how management measures segment profit and loss (see Note 14, Business Segments and Major Customers for a description of segment profit (loss) in our unaudited condensed consolidated financial statements). Management evaluates segment profit and loss in this manner, excluding the amortization of deferred airborne lease incentives, because such presentation reflects operating decisions and activities from the current period, without regard to the prior period decision or the form of connectivity agreements. See Key Components of Consolidated Statements of Operations Cost of Service Revenue Commercial Aviation North America and Rest of World in our 2014 10-K for a discussion of the accounting treatment of deferred airborne lease incentives.

We also present Adjusted EBITDA as a supplemental performance measure because we believe that this measure provides investors, securities analysts and other users of our financial statements with important supplemental information with which to evaluate our performance and to enable them to assess our performance on the same basis as management.

Adjusted Net Loss Per Share represents net loss attributable to common stock per share basic and diluted, adjusted to reflect the number of shares of common stock outstanding as of March 31, 2015 under our current capital structure, after giving effect to the shares of our common stock effectively repurchased as part of the Forward Transactions entered into in connection with the issuance of the Convertible Notes. We present Adjusted Net Loss Per Share to provide investors, securities analysts and other users of our financial statements with important supplemental information with which to evaluate our performance considering our current capital structure and the shares outstanding after giving effect to the Forward Transactions.

Cash CAPEX represents capital expenditures net of airborne equipment proceeds received from the airlines and incentives paid to us by landlords under certain facilities leases. We believe Cash CAPEX provides a more representative indication of our liquidity requirements with respect to capital expenditures, as under certain agreements with our airline partners we are reimbursed for all or a substantial portion of the cost of our airborne equipment, thereby reducing our cash capital requirements.

Gogo Inc. and Subsidiaries

Reconciliation of GAAP to Non-GAAP Measures

(in thousands, except per share amounts)

(unaudited)

	For the Three Months Ended March 31, 2015	For the Three Months Ended March 31, 2014
Adjusted EBITDA:		
Net loss attributable to common stock (GAAP)	$ (20,092)	$ (16,866)
Interest expense	10,095	7,248
Interest income	(5)	(15)
Income tax provision	294	273
Depreciation and amortization	18,777	15,687
EBITDA	9,069	6,327
Stock-based compensation expense	3,085	1,604
Amortization of deferred airborne lease incentives	(3,926)	(2,597)
Adjusted EBITDA	$ 8,228	$ 5,334
Adjusted Net Loss Per Share:		
Net loss attributable to common stock	$ (20,092)	$ (16,866)
Basic and diluted weighted average shares outstanding (GAAP)	83,126	84,995
Adjustment of shares to our current capital structure		(1,869)

Adjusted shares outstanding	83,126	83,126
Adjusted Net Loss Per Share basic and diluted	$ (0.24)	$ (0.20)
Cash CAPEX:		
Consolidated capital expenditures (GAAP) *(1)*	$ (56,863)	$ (36,095)
Change in deferred airborne lease incentives *(2)*	8,721	4,965
Amortization of deferred airborne lease incentives *(2)*	3,875	2,490
Landlord incentives	12,236	
Cash CAPEX	$ (32,031)	$ (28,640)

(1) See unaudited condensed consolidated statements of cash flows.

(2) Excludes deferred airborne lease incentives and related amortization associated with STCs for the three months ended March 31, 2015 and 2014 as STC costs are expensed as incurred as part of Engineering, Design and Development.

Material limitations of Non-GAAP measures

Although EBITDA, Adjusted EBITDA, Adjusted Net Loss Per Share and Cash CAPEX are measurements frequently used by investors and securities analysts in their evaluations of companies, EBITDA, Adjusted EBITDA, Adjusted Net Loss Per Share and Cash CAPEX each have limitations as an analytical tool, and you should not consider them in isolation or as a substitute for, or more meaningful than, amounts determined in accordance with GAAP.

Some of these limitations are:

EBITDA and Adjusted EBITDA do not reflect interest income or expense;

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EBITDA and Adjusted EBITDA do not reflect cash requirements for our income taxes;

EBITDA and Adjusted EBITDA do not reflect depreciation and amortization, which are significant and unavoidable operating costs given the level of capital expenditures needed to maintain our business;

Adjusted EBITDA does not reflect non-cash components related to employee compensation;

Cash CAPEX does not reflect the full extent of capital investments we have made in our operations; and

other companies in our or related industries may calculate these measures differently from the way we do, limiting their usefulness as comparative measures.

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Liquidity and Capital Resources

The following table presents a summary of our cash flow activity for the periods set forth below *(in thousands)*:

	For the Three Months Ended March 31, 2015	2014
Net cash provided by (used in) operating activities	$ 33,606	$ (6,809)
Net cash used in investing activities	(56,844)	(38,594)
Net cash provided by (used in) financing activities	211,869	(1,377)
Effect of foreign exchange rate changes on cash	189	10
Net increase (decrease) in cash and cash equivalents	188,820	(46,770)
Cash and cash equivalents at the beginning of period	211,236	266,342
Cash and cash equivalents at the end of period	$ 400,056	$ 219,572

We have historically financed our growth and cash needs primarily through the issuance of common stock, non-convertible debt, convertible debt, senior convertible preferred stock, term debt facilities and cash from operating activities. We continually evaluate our ongoing capital needs in light of increasing demand for our services, limitations on bandwidth capacity, evolving technologies in our industry and related strategic, operational and technological opportunities. We actively consider opportunities to raise additional capital in the public and private markets utilizing one or more of the types of capital raising transactions through which we have historically financed our growth and cash needs, as well as other means of capital raising not previously used by us.

Convertible Notes:

On March 3, 2015, we issued $340.0 million aggregate principal amount of Convertible Notes in a private offering to qualified institutional buyers, pursuant to Rule 144A under the Securities Act of 1933, as amended. We granted an option to the initial purchasers to purchase up to an additional $60.0 million aggregate principal amount of Convertible Notes to cover over-allotments, of which $21.9 million was subsequently exercised during March 2015, resulting in a total issuance of $361.9 million aggregate principal amount of Convertible Notes. We expect to use the net proceeds from the Convertible Notes, after giving effect of the Forward Transactions, for working capital and other general corporate purposes, including potential costs associated with developing and launching our next-generation technology solutions and the acquisition of additional spectrum should it become available. The Convertible Notes mature on March 1, 2020 unless earlier repurchased or converted into shares of our common stock under certain circumstances described below. Upon maturity, we have the option to settle our obligation through cash, shares of common stock, or a combination of cash and shares of common stock. We pay interest on the Convertible Notes semi-annually in arrears on March 1 and September 1 of each year, beginning on September 1, 2015.

The $361.9 million of proceeds received from the issuance of the Convertible Notes were initially allocated between long-term debt (the liability component) at $261.9 million, and additional paid-in-capital, (the equity component) at $100.0 million, within the unaudited condensed consolidated balance sheet. The fair value of the liability component was measured using rates determined for similar debt instruments without a conversion feature. The carrying amount of the equity component, representing the conversion option, was determined by deducting the fair value of the liability component from the aggregate face value of the Convertible Notes. If we or the note holders elect not to settle the debt through conversion, we must settle the Convertible Notes at face value. Therefore, the liability component will be accreted up to the face value of the Convertible Notes, which will result in additional non-cash interest expense being recognized within the unaudited condensed consolidated statements of operations through the Convertible Notes maturity date (see Note 9, Interest Costs for additional information). The effective interest rate on the Convertible Notes, including accretion of the notes to par and debt issuance cost amortization, was approximately 11.5% for the three month period ended March 31, 2015. The equity component will not be remeasured as long as it continues to meet the conditions for equity classification.

As of March 31, 2015, the outstanding principal on the Convertible Notes was $361.9 million, the unamortized debt discount was $99.0 million, and the net carrying amount of the liability component was $262.9 million, which was recorded as long-term debt within the unaudited condensed consolidated balance sheet.

We incurred approximately $10.4 million of issuance costs related to the issuance of the Convertible Notes during the three month period ended March 31, 2015. Of the $10.4 million of issuance costs incurred, $7.5 million and $2.9 million were recorded to deferred financing costs and additional paid-in capital, respectively, in proportion

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to the allocation of the proceeds of the Convertible Notes. The $7.5 million recorded as deferred financing costs on the unaudited condensed consolidated balance sheet is being amortized over the contractual term of the Convertible Notes using the effective interest method. See Note 9, Interest Costs for additional information.

The Convertible Notes had an initial conversion rate of 41.9274 common shares per $1,000 principal amount of the Convertible Notes, which is equivalent to an initial conversion price of approximately $23.85 per share of our common stock. Upon conversion, we currently expect to deliver cash up to the principal amount of the Convertible Notes then outstanding. With respect to any conversion value in excess of the principal amount, we currently expect to deliver shares of our common stock, unless we elect to deliver cash in lieu of all or a portion of such shares. The shares of common stock subject to conversion are excluded from diluted earnings per share calculations under the if-converted method as their impact is anti-dilutive.

Holders may convert notes, at their option, in multiples of $1,000 principal amount at any time prior to December 1, 2019, but only in the following circumstances:

- during any fiscal quarter beginning after the fiscal quarter ending June 30, 2015, if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during the last 30 consecutive trading days of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price of the Convertible Notes on each applicable trading day;

- during the five business day period following any five consecutive trading day period in which the trading price for the Convertible Notes is less than 98% of the average of the closing sale price of our common stock for each day during such five trading day period; or

- upon the occurrence of specified corporate events.

Regardless of whether any of the foregoing circumstances occurs, holders may convert their Convertible Notes, in multiples of $1,000 principal amount, at any time on or after December 1, 2019 until maturity.

In addition, if we undergo a fundamental change (as defined in the indenture governing the Convertible Notes), holders may, subject to certain conditions, require us to repurchase their Convertible Notes for cash at a price equal to 100% of the principal amount of the Convertible Notes to be purchased, plus any accrued and unpaid interest. In addition, if specific corporate events occur prior to the maturity date, we will increase the conversion rate for a holder who elects to convert their Convertible Notes in connection with such a corporate event in certain circumstances.

In connection with the issuance of the Convertible Notes, we paid approximately $140 million to enter into the Forward Transactions with certain financial institutions, (the Forward Counterparties), pursuant to which we purchased approximately 7.2 million shares of common stock for settlement on or around the March 1, 2020 maturity date for the Convertible Notes, subject to the ability of each Forward Counterparty to elect to settle all or a portion of its Forward Transactions early. As a result of the Forward Transactions, total shareholders equity within our unaudited condensed consolidated balance sheet was reduced by approximately $140 million during the three month period ended March 31, 2015. Approximately 7.2 million shares of common stock that will be effectively repurchased through the Forward Transactions are treated as retired shares for basic and diluted EPS purposes although they remain legally outstanding.

Senior Term Facility:

On July 30, 2014, Gogo Intermediate Holdings LLC, Gogo Business Aviation LLC, f/k/a Aircell Business Aviation Services LLC (GBA), and Gogo LLC, as borrowers (the Borrowers), entered into an Amendment and Restatement Agreement (the Amendment) to the Credit Agreement dated as of June 21, 2012 and amended on April 4, 2013 (the Amended Senior Term Facility) among the Borrowers, the lenders named therein, and Morgan Stanley Senior Funding, Inc., as Administrative Agent and Collateral Agent. We refer to the Amendment and the Amended Senior Term Facility collectively as the Amended and Restated Senior Term Facility.

Prior to the Amendment, under the Amended Senior Term Facility we borrowed an aggregate principal amount of $248.0 million (the Tranche B-1 Loans). Pursuant to the Amendment, we borrowed an additional principal amount of $75.0 million (the Tranche B-2 Loans and, together with the Tranche B-1 Loans, the Loans). As of March 31, 2015 and December 31, 2014, we had $306.7 million and $309.2 million, respectively, outstanding under the Amended and Restated Senior Term Facility.

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See Note 8, Long-Term Debt and Other Liabilities in our unaudited condensed consolidated financial statements for additional information.

Maturity; Prepayments

The maturity date of the Amended and Restated Senior Term Facility is March 21, 2018. Principal payments of $1.7 million are due on the last day of each calendar quarter through December 31, 2017, with the remaining unpaid principal amount due and payable at maturity.

The credit agreement executed in connection with our Amended and Restated Senior Term Facility provides for mandatory prepayments and the ability to make optional prepayments. Based on historical and current expectations regarding cash flow generation, the credit agreement was structured to provide that any mandatory prepayments will be calculated based on the excess cash flows (as defined in the credit agreement) of GBA only. This calculation is made at the end of each fiscal year, with any required payments due no later than the 95th day following the end of the applicable fiscal year, and is based on GBA s debt leverage ratio. A leverage ratio of 3.25x or higher will trigger a mandatory prepayment of 50% of excess cash flows for the year, a leverage ratio of 2.0x or higher but less than 3.25x will trigger a mandatory prepayment of 25% of excess cash flows for the year and a leverage ratio of less than 2.0x will not trigger any mandatory prepayment of excess cash flows. The amount of any required mandatory prepayments will be reduced by the amount of any optional prepayments made during the applicable fiscal year. In the event actual results or a change in estimates triggers the mandatory prepayment, such prepayment amount will be reclassified from non-current liabilities to current liabilities in our consolidated balance sheet. We had no such mandatory prepayment classified as a current liability as of March 31, 2015. As of December 31, 2014, we calculated a mandatory prepayment of approximately $0.9 million, which was paid in March 2015.

We may voluntarily prepay the loans subject to conditions, prices and premiums as follows:

(i) On and prior to December 21, 2015, we may prepay the loans at par plus (a) 3.0% of the principal amount of the loans prepaid and (b) a make whole premium based on a discounted present value of the interest and principal payments due on such prepaid loans through December 21, 2015;

(ii) After December 21, 2015 but prior to December 21, 2016, we may prepay the loans at par plus 3.0% of the principal amount of loans prepaid;

(iii) On and after December 21, 2016, we may prepay the loans at par.

Interest; Fees

The interest rates applicable to the Tranche B-1 Loans are based on a fluctuating rate of interest measured by reference, at GBA s option, to either (i) a London inter-bank offered rate adjusted for statutory reserve requirements (LIBOR) (subject to a 1.50% floor) plus an applicable margin of 9.75% per annum, or (ii) an alternate base rate (Base Rate) (subject to a 2.50% floor) plus an applicable margin of 8.75% per annum. The interest rates applicable to the Tranche B-2 Loans are based on a fluctuating rate of interest measured by reference, at GBA s option, to either (i) LIBOR (subject to a 1.00% floor) plus an applicable margin of 6.50% per annum, or (ii) a Base Rate (subject to a 2.00% floor) plus an applicable margin of 5.50% per annum. As of March 31, 2015, all loans were outstanding as three month LIBOR loans, and the interest rates on the Tranche B-1 Loans and the Tranche B-2 Loans were 11.25%

and 7.50%, respectively. We pay customary fees in respect of the Amended and Restated Senior Term Facility.

We paid $22.2 million of loan origination fees and financing costs related to the Amended and Restated Senior Term Facility, all but $4.1 million of which has been accounted for as deferred financing costs. The $4.1 million of fees that were not accounted for as deferred financing costs were fees not paid directly to the lenders in connection with the amendments in April 2013 and July 2014 and were expensed to interest expense. See Note 9, Interest Costs, in our unaudited condensed consolidated financial statements for additional details. Total amortization expense of the deferred financing costs was $0.7 million for the three month period ended March 31, 2015 as compared with $0.8 million for the prior year period. Amortization expense is included in interest expense in the unaudited condensed consolidated statements of operations. As of March 31, 2015 and December 31, 2014, the balance of unamortized deferred financing costs related to the Amended and Restated Senior Term Facility was $10.6 million and $11.3 million, respectively, which was included as a separate line in our unaudited condensed consolidated balance sheet.

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Covenants

The Amended and Restated Senior Term Facility contains a number of covenants that, among other things, limit or restrict the ability of the borrowers and the guarantors to dispose of assets, incur or guarantee additional indebtedness, prepay certain subordinated indebtedness, modify certain terms of certain material agreements (including intercompany agreements), make dividends and other restricted payments, issue additional preferred stock, make investments (including a cap on investments in our international business during the term of the Amended and Restated Senior Term Facility), incur or maintain liens, make capital expenditures, engage in mergers and certain other fundamental changes, engage in certain transactions with affiliates, enter into sale-leaseback arrangements or enter into agreements restricting dividends or other distributions by subsidiaries to the borrowers or any of their subsidiaries.

Letters of Credit:

We maintain several letters of credit totaling $7.9 million and $7.9 million as of March 31, 2015 and December 31, 2014, respectively. Certain of the letters of credit require us to maintain restricted cash accounts in a similar amount, and are issued for the benefit of the landlords at our existing office locations in Itasca, Illinois; Bensenville, Illinois; and Broomfield, Colorado; and our future office location in Chicago, Illinois.

Liquidity:

Although we can provide no assurances, we currently believe that cash and cash equivalents on hand as of March 31, 2015, together with our other sources of cash, should be sufficient to meet our working capital and capital expenditure requirements for at least the next twelve months, including installing our ATG-4 equipment on certain aircraft operated by our airline partners, costs related to international expansion and potential costs associated with developing and launching our next-generation technology solutions and the acquisition of additional spectrum should it become available. We have not generated positive cash flows on a consolidated basis, and our ability to do so will depend in large part on our ability to increase revenues in each of our three business segments. In addition, our ability to generate positive cash flows from operating activities and the timing of certain capital and other necessary expenditures are subject to numerous variables, such as the availability and costs associated with next-generation technologies, costs related to international expansion and execution of our current technology roadmap. We currently believe that cash on hand and, if necessary, additional equity financings or the incurrence of additional debt as permitted under the credit agreement governing our Amended and Restated Senior Term Facility, will be sufficient to meet our liquidity needs in the longer-term, including our anticipated international expansion. The credit agreement governing the Amended and Restated Senior Term Facility contains covenants that restrict the ability of Gogo Intermediate Holdings LLC, GBA and Gogo LLC to incur additional indebtedness generally, subject to certain enumerated exceptions, and to undertake certain equity financings through the issuance of certain types of preferred stock. As a result, we may be unable to finance growth of our business to the extent that our cash on hand and cash generated through operating activities prove insufficient and we are unable to raise additional financing through the issuance of common equity or through permitted sales of preferred equity or debt.

Cash flows provided by (used in) Operating Activities:

The following table presents a summary of our cash flows from operating activities for the periods set forth below *(in thousands)*:

	For the Three Months Ended March 31,	
	2015	2014
Net loss	$ (20,092)	$ (16,866)
Non-cash charges and credits	24,585	18,520
Changes in operating assets and liabilities	29,113	(8,463)
Net cash provided by (used in) operating activities	$ 33,606	$ (6,809)

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For the three month period ended March 31, 2015, cash provided by operating activities was $33.6 million as compared with cash used in operating activities of $6.8 million for the prior year period. The principal contributors to the increase in operating cash flows were:

- A $37.6 million increase in cash flows related to changes in operating assets and liabilities resulting from:
  - An increase in cash flows due to the following:
    - Changes in CA-NA and BA s deferred rent due to the commencement of the new facilities leases during 2014;
    - Changes in CA-NA deferred revenue due to an increase in subscription based products and buy-before-you-fly user purchase options;
    - Changes in CA-NA and CA-ROW s accounts receivable due to the collection of receivables in 2015 that built throughout 2014;
    - Changes in CA-NA and BA s accrued liabilities and prepaid expense and other current assets primarily due to the timing of payments; and
    - Changes in CA-ROW deferred airborne lease incentives due to additional installations of our equipment in 2015.
  - Partial offsets to the above due to decreases in cash flows from the following:
    - Changes in BA s inventory due to the building of inventory balances to support future growth; and
    - Changes in CA-NA and BA s accounts payable due to the timing of payments.
- A $2.8 million decrease in net loss adjusted for non-cash charges and credits that was due primarily to increases in the CA-NA and BA segments service revenues partially offset by increased spending in all three segments, as noted above under Results of Operations.

We anticipate cash flows from changes in operating assets and liabilities to be positively impacted in 2015 by increases in deferred airborne lease incentives and incentives payable to us by landlords under certain facilities leases, which we estimate will range from $65 million to $85 million for the year ending December 31, 2015.

Cash flows used in Investing Activities:

Cash used in investing activities is primarily for capital expenditures related to airborne equipment, cell site construction, software development, and data center upgrades. See Capital Expenditures below.

Cash flows provided by (used in) Financing Activities:

Cash provided by financing activities for the three month period ended March 31, 2015 was $211.9 million primarily due to proceeds from the issuance of the Convertible Notes of $361.9 million and proceeds from the exercise of stock options of $2.6 million, partially offset by payments associated with the Forward Transactions of $140.0 million, the payment of debt issuance costs for the Convertible Notes of $9.5 million and payments on our debt facilities and capital leases of $3.1 million.

Cash used in financing activities for the three month period ended March 31, 2014 of $1.4 million was primarily due to payments under our debt facilities partially offset by exercise of stock options.

Capital Expenditures

Our operations continue to require significant capital expenditures primarily for technology development, equipment, and capacity expansion. Capital expenditures for the CA-NA and CA-ROW segments are associated with the installation and the supply of airborne equipment to our airline partners. Capital spending is also associated with the expansion of our ATG network and data centers and includes site acquisition, design, permitting, network equipment and construction costs. Capital expenditures related to data centers are for additional equipment such as servers and IP routers. We capitalize software development costs related to network technology solutions, the Gogo platform and new product/service offerings. We also capitalize costs related to the build out of our new office locations.

Capital expenditures for the three month periods ended March 31, 2015 and 2014 were $56.9 million and $36.1 million, respectively. The increase in capital expenditures was due to the build out of our new office location in Chicago, IL and an increase in airborne equipment purchases for the CA-ROW and CA-NA segments, offset in part by a decrease in network spending in CA-NA.

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We anticipate an increase in capital spending in 2015 versus 2014 and estimate capital expenditures for the year ending December 31, 2015 will range from $165 million to $205 million as we increase the number of airborne equipment installations, execute our international expansion strategy, install our ATG-4 equipment on certain aircraft operated by our airline partners and build out our new office facilities. We expect our capital expenditures, net of deferred airborne lease incentives and landlord lease incentives as noted above, for the year ending December 31, 2015 to range from $100 million to $120 million. Our expected range of capital expenditures for the year ending December 31, 2015 does not account for any potential costs associated with the participation in any future auction for the licensing of additional spectrum or any related technology or service arrangements necessary to utilize such spectrum.

Contractual Commitments: We have agreements with airborne equipment vendors under which we have remaining commitments to purchase $12.7 million in satellite based systems and development services as of March 31, 2015. Such commitments will become payable as we receive the equipment and are provided the development services.

We have agreements with vendors to provide us with transponder and teleport satellite services. These agreements vary in length and amount and commit us to purchase transponder and teleport satellite services totaling approximately $25.7 million in 2015 (April through December), $33.4 million in 2016, $31.8 million in 2017, $15.3 million in 2018 and an amount less than $0.1 million in 2019.

Leases and Cell Site Contracts: We have lease agreements relating to certain facilities and equipment, which are considered operating leases. Rent expense for such operating leases was $4.3 million for the three month period ended March 31, 2015 as compared with $1.6 million for the prior year period. The increase is due to us incurring rent expense for the new Broomfield, CO and Chicago, IL offices beginning in the second half of 2014. Additionally, we have operating leases with wireless service providers for tower space and base station capacity on a volume usage basis (cell site leases), some of which provide for minimum annual payments. Our cell site leases generally provide for an initial noncancelable term of up to five years with up to four five-year renewal options. Total cell site rental expense was $2.3 million for the three month period ended March 31, 2015 as compared to $2.2 million for the prior year period.

The revenue share paid to our airline partners represents an operating lease payment and is deemed to be contingent rental payments, as the payments due to each airline are based on a percentage of our CA-NA and CA-ROW service revenue generated from that airline s passengers, which is unknown until realized. As such, we cannot estimate the lease payments due to an airline at the commencement of our contract with such airline. Rental expense related to the arrangements with commercial airlines included in cost of service revenue is primarily comprised of these revenue share payments offset by the amortization of the deferred airborne lease incentive discussed above. Such rental expense totaled a net charge of $10.3 million for the three month period ended March 31, 2015 as compared to $9.9 million for the prior year period. See Note 10, Leases, in our unaudited condensed consolidated financial statements for additional information.

One contract with one of our airline partners requires us to provide our airline partner with a cash rebate of $1.8 million if our service is available on a specified number of aircraft in such airline partner s fleet on the preceding December 31, in June of each year from 2015 through 2023. Based upon the number of aircraft in service on December 31, 2014, we will be required to rebate $1.8 million to this airline in June 2015.

Indemnifications and Guarantees: In accordance with Delaware law, we indemnify our officers and directors for certain events or occurrences while the officer or director is, or was, serving at our request in such capacity. The maximum potential amount of future payments we could be required to make under this indemnification is uncertain and may be unlimited, depending upon circumstances. However, our Directors and Officers insurance does provide coverage for certain of these losses.

In the ordinary course of business we may occasionally enter into agreements pursuant to which we may be obligated to pay for the failure of performance of others, such as the use of corporate credit cards issued to employees. Based on historical experience, we believe that the risk of sustaining any material loss related to such guarantees is remote.

We have entered into a number of agreements, including our agreements with commercial airlines, pursuant to which we indemnify the other party for losses and expenses suffered or incurred in connection with any patent, copyright, or trademark infringement or misappropriation claim asserted by a third party with respect to our equipment or services. The maximum potential amount of future payments we could be required to make under these indemnification agreements is uncertain and is typically not limited by the terms of the agreements.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Our exposure to market risk is currently confined to our cash and cash equivalents and our debt. We have not used derivative financial instruments for speculation or trading purposes. The primary objectives of our investment activities are to preserve our capital for the purpose of funding operations while at the same time maximizing the income we receive from our investments without significantly increasing risk. To achieve these objectives, our investment policy allows us to maintain a portfolio of cash equivalents and short-term investments through a variety of securities, including commercial paper, certificates of deposit, money market funds and corporate debt securities. Our cash and cash equivalents as of March 31, 2015 and December 31, 2014 included amounts in bank checking account and liquid certificates of deposit with short term maturities. We believe that a change in average interest rates would not adversely affect our interest income and results of operations by a material amount.

The risk inherent in our market risk sensitive instruments and positions is the potential loss arising from interest rates as discussed below. The sensitivity analyses presented do not consider the effects that such adverse changes may have on the overall economic activity, nor do they consider additional actions we may take to mitigate our exposure to such changes. Actual results may differ.

Interest: Our earnings are affected by changes in interest rates due to the impact those changes have on interest income generated from our cash and cash equivalents and interest expense on our long-term debt. Our cash and cash equivalents as of March 31, 2015 and December 31, 2014 included amounts in bank checking accounts and liquid certificates of deposit. We believe we have minimal interest rate risk; a 10% change in the average interest rate on our portfolio, would have reduced interest income and increased interest expense for the three month periods ended March 31, 2015 and 2014 by an immaterial amount.

Variable Rate Debt: The interest rates applicable to the Tranche B-1 Loans (as defined in Note 8, Long-Term Debt and Other Liabilities, in our unaudited condensed consolidated financial statements) are based on a fluctuating rate of interest measured by reference, at GBA s option, to either (i) a London inter-bank offered rate adjusted for statutory reserve requirements (LIBOR) (subject to a 1.50% floor) plus an applicable margin of 9.75% per annum, or (ii) an alternate base rate (Base Rate) (subject to a 2.50% floor) plus an applicable margin of 8.75% per annum. The interest rates applicable to the Tranche B-2 Loans (as defined in Note 8, Long-Term Debt and Other Liabilities, in our unaudited condensed consolidated financial statements) are based on a fluctuating rate of interest measured by reference, at GBA s option, to either (i) LIBOR (subject to a 1.00% floor) plus an applicable margin of 6.50% per annum, or (ii) a Base Rate (subject to a 2.00% floor) plus an applicable margin of 5.50% per annum. As of March 31, 2015, all loans were outstanding as three month LIBOR loans, and the interest rates on the Tranche B-1 Loans and the Tranche B-2 Loans were 11.25% and 7.50%, respectively. As of March 31, 2015, the LIBOR Rate was more than 100 basis points below the floor described above. As a result, the fair value of the Amended and Restated Senior Term Facility will not change until both the LIBOR Rate and the applicable base rate exceeds the applicable floors. However, if the interest rate were to increase or decrease by 100 basis points on our outstanding loans, the fair value of the Amended and Restated Senior Term Facility would increase or decrease by approximately $19.9 million.

Inflation: We do not believe that inflation has had a material effect on our results of operations. However, there can be no assurance that our business will not be affected by inflation in the future.

Seasonality: Our results of operations for any interim period are not necessarily indicative of those for any other interim period of for the entire year because the demand for air travel, including business travel, is subject to significant seasonal fluctuations. We generally expect overall passenger opportunity to be greater in the second and third quarters compared to the rest of the year due to an increase in leisure travel offset in part by a decrease in business travel during the summer months and holidays. We expect seasonality of the air transportation business to continue, which may affect our results of operations in any one period.

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ITEM 4. Controls and Procedures
(a) Evaluation of Disclosure Controls and Procedures

Management, with the participation of our Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of March 31, 2015. Based upon this evaluation, our Chief Executive Officer and the Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of March 31, 2015.

(b) Changes in Internal Control over Financial Reporting

There have been no changes to our internal control over financial reporting in connection with the evaluation required by Rules 13a-15(f) and 15d-15(f) under the Exchange Act during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

On February 25, 2014, Adam Berkson filed suit against us in the United States District Court for the Eastern District of New York, on behalf of putative classes of national purchasers and a subclass of New York purchasers of our connectivity service, alleging claims that we violated New York and other consumer protection laws, as well as an implied covenant of good faith and fair dealing, by misleading consumers about recurring charges for our service. The suit seeks unspecified damages. We have not accrued any liability related to this matter due to the early stage of the litigation and the difficulty of predicting the outcome. Based on currently available information, we believe we have strong defenses and intend to defend this lawsuit vigorously, but the outcome of this matter is inherently uncertain and may have a material adverse effect on our financial position, results of operations and cash flows.

In addition to the matters discussed above, from time to time we may become involved in legal proceedings arising in the ordinary course of our business. We cannot predict with certainty the outcome of any litigation or the potential for future litigation. Regardless of the outcome of any particular litigation and the merits of any particular claim, litigation can have a material adverse impact on our company due to, among other reasons, any injunctive relief granted, which could inhibit our ability to operate our business, amounts paid as damages or in settlement of any such matter, diversion of management resources and defense costs.

ITEM 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014 as filed with the SEC on February 27, 2015.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.

a) Sales of Unregistered Securities

None.

b) Use of Proceeds from Public Offering of Common Stock

On June 20, 2013, our registration statement on Form S-1 (File No. 333-178727) was declared effective by the Securities and Exchange Commission for our IPO, pursuant to which we sold an aggregate of 11,000,000 shares of our common stock at a price of $17.00 per share. There has been no material change in the planned use of proceeds from our IPO as described in our prospectus filed with the Securities and Exchange Commission on June 24, 2013 pursuant to Rule 424(b). Upon the closing of the IPO, we invested the funds received in registered money market funds and U.S. treasury securities.

c) Issuer Purchases of Equity Securities

The following is a summary of our repurchases of shares of common stock during the three months ended March 31, 2015:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Par of Publically Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under Plans Or Programs (in thousands)
January 1 January 31		$		$
February 1 February 28		$		$
March 1 March 31	7,190,549(1)	$ 19.47	7,190,549(1)	$
	7,190,549	$ 19.47	7,190,549	$

(1) Although the 7.2 million shares of common stock that will be effectively repurchased through the Forward Transactions are not legally retired and remain outstanding as of March 31, 2015, these shares are reflected in the above table as they are considered participating securities for basic and diluted EPS purposes under certain circumstances. See Note 3, Net Loss Per Share for further information.

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ITEM 3. Defaults Upon Senior Securities.

None.

ITEM 4. Mine Safety Disclosures

None.

ITEM 5. Other Information.

a) None.

b) None.

ITEM 6. Exhibits.

Exhibit Number	Description of Exhibits
4.3	Indenture, dated March 9, 2015, between Gogo Inc. and U.S. Bank National Association (incorporated by reference to Exhibit 4.1 to Form 8-K filed on March 9, 2015)
4.4	Global 3.75% Convertible Senior Note due 2020, dated March 9, 2015 (incorporated by reference to Exhibit 4.2 to Form 8-K filed on March 9, 2015)
10.10.1	Purchase Agreement, dated March 3, 2015, by and among Gogo Inc., J.P. Morgan Securities LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated (incorporated by reference to Exhibit 10.1 to Form 8-K filed on March 9, 2015)
10.10.2	Forward Stock Purchase Confirmation, dated March 3, 2015, by and between Gogo Inc. and JPMorgan Chase Bank, National Association, London Branch (incorporated by reference to Exhibit 10.2 to Form 8-K filed on March 9, 2015)
10.10.3	Forward Stock Purchase Confirmation, dated March 3, 2015, by and between Gogo Inc. and Merrill Lynch International, acting through its agent, Merrill Lynch, Pierce, Fenner & Smith Incorporated (incorporated by reference to Exhibit 10.3 to Form 8-K filed on March 9, 2015)
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1 *	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2 *	

	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

* This certification accompanies the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Registrant under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.

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SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Gogo Inc.

Date: May 7, 2015

/s/ Michael Small
Michael Small
President and Chief Executive Officer
(Principal Executive Officer)

/s/ Norman Smagley
Norman Smagley
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

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T>62,202 49.2% 59,708 47.4% 56,253 46.7%

% change from prior year

4.2% 6.0% (0.7)%

Surface

5,727 4.5% 6,252 5.0% 6,667 5.6%

% change from prior year

(8.4)% (6.2)% (0.2)%

Total

126,364 100.0% 125,892 100.0% 120,353 100.0%

% change from prior year

0.4% 4.6% (1.3)%

Purchased water expenses are affected by changes in quantities purchased, supplier prices, and cost differences between wholesale suppliers. The MCBA mechanism is designed to recover all incurred purchase water expenses. For 2013, the $21.8 million increase in purchased water is due to wholesaler water rate increases between 3% and 12% and a 4% increase in purchased quantities. On an overall blended basis, wholesale water rates increased 8% on a cost-per-million-gallon basis in 2013. Purchased water expense for 2013 was partially offset by lease water rights credits of $1.0 million.

For 2012, the $18.7 million increase in purchased water is due to wholesaler water rate increases between 3% and 12% and a 6% increase in purchased quantities. On an overall blended basis, wholesale water rates increased 7% on a cost-per-million-gallon basis in 2012. Purchased water expense for 2012 was partially offset by lease water rights credits of $0.9 million.

For 2011, the $16.7 million increase in purchased water is due to wholesaler water rate increases between 3% and 38% despite a 1% decrease in purchased quantities. On an overall blended basis, wholesale water rates increased 14% on a cost-per-million-gallon basis in 2011. Purchased water expense for 2011 was partially offset by lease water rights credits of $1.0 million.

See Item 1, "Rates and Regulation" of this annual report.

Purchased power expenses are affected by the quantity of water pumped from wells and moved through the distribution system, rates charged by electric utility companies, and rate structures applied to usage during peak and non-peak times of the day or season. In 2013, 2012, and 2011 purchased power expense increased $1.2 million, or 4%, $0.9 million, or 3%, and $0.5 million, or 2%, respectively, primarily due to power supplier rate increases.

Changes in climate change regulations could increase the cost of purchased power which in turn would result in an increase in the rates our power suppliers charge us. Any change in pricing of our purchased power in California would be recovered from our rate payers by the MCBA. Any change in power costs in other states would be requested to be recovered by the rate payers in those states. The impact of such legislation, is dependent upon the enacted date, the factors that impact our suppliers cost structure, and their ability to pass the costs to us in their approved tariffs. These items are not known at this time.

Administrative and General Expenses

Administrative and general expenses include payroll related to administrative and general functions, all employee benefits charged to expense accounts, insurance expenses, legal fees, expenses associated with being a public company, and general corporate expenses.

During 2013, administrative and general expenses increased $4.1 million, or 4.4%, as compared to 2012. The increase was due primarily to increases in employee payroll costs, health care, pension and other employee benefit costs. These increases were partially offset by a reduction to outside service costs.

During 2012, administrative and general expenses increased $8.2 million, or 9.5%, as compared to 2011. The increase was due primarily to increases in employee payroll costs, health care, pension, other employee benefit costs, and outside service costs.

Other Operations Expenses

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

During 2013, other operating expenses decreased $7.4 million, or 9.6%, compared to 2012 mainly due to $10.5 million of MCBA costs from the recording of the 2011 deferred WRAM revenues and associated costs recorded during 2012 and the decrease was partially offset by $2.6 million of increased conservation program expenses in 2013 compared to 2012. Conservation program expenses are fully recovered in rates for 2011, 2012, and 2013, and are tracked in a balancing account, such that revenues are recovered on a dollar-for-dollar basis up to the amounts authorized in the 2009 GRC.

During 2012, other operating expenses increased $22.4 million, or 41%, compared to 2011 primarily attributable to $10.5 million of MCBA costs from the recording of the 2011 deferred WRAM revenues and associated costs recorded during 2012, increased labor and benefit costs related to the operating activities and increased conservation program expenses compared to 2011.

Maintenance

Maintenance expenses decreased $1.8 million, or 9.3%, in 2013, compared to 2012 due to decreased costs for repairs of mains, services, meters, hydrants, and other structures. For 2012, maintenance expenses decreased $1.6 million, or 7.5%, compared to 2011 due to decreased costs for repairs of mains, services, meters, hydrants, and other structures

Depreciation and Amortization

Depreciation and amortization increased $3.7 million in 2013 due to capital additions from 2012, and increased $4.3 million in 2012 due to capital additions from 2011.

Our capital expenditures in California will be impacted by certain California environmental legislation passed in prior years. The CEQA permitting process involved in certain capital projects has increased the administrative cost of certain projects. California emission controls are expected to increase the cost of vehicle acquisitions. Certain existing vehicles will also have to be retrofitted to comply with the current legislation. The costs will be recovered via depreciation expense by our rate payers upon the filing of future general rate cases.

Income Taxes

For 2013, income taxes decreased $1.0 million as compared to 2012. For 2012, income taxes decreased $1.7 million as compared to 2011. The effective tax rate was 30.2% (with the tax accounting method change, which reduced 2013 state income taxes by $2.4 million), 31.7% (with the tax accounting method change, which reduced 2012 state income taxes by $7.0 million), and 38.4%, in 2013, 2012, and 2011, respectively. The tax rate is also affected by the flow through method of accounting for income taxes which resulted from differences between tax depreciation and book depreciation on both pre-1982 assets, as well as all California assets. The flow through method of accounting is described in the Summary of Significant Accounting Policies in the Notes to Consolidated Financial Statements. We anticipate the reversal of federal tax depreciation on pre-1982 assets to continue in future years; however, its effect on our tax provision is uncertain due to the offsetting flow-through of state tax depreciation, which continues to increase with capital additions and the impact of cost to remove pre-1982 assets. In September of 2010, the 50% bonus depreciation for federal income tax filings was extended through 2013 and on January 2, 2013 was extended through December 31, 2013, which reduced 2013, 2012 and 2011 income tax payments $2.1 million, $5.0 million, and $12.6 million, respectively.

Property and Other Taxes

For 2013, property and other tax expenses increased $2.3 million, or 11.9% from 2012. The increase was primarily due to increased property taxes for utility plant placed in service during 2012, increased payroll taxes, and increased franchise taxes. For 2012, property and other tax expenses increased $0.9 million, or 4.9% from 2011. The increase was primarily due to increased property taxes due to utility plant additions during 2011 and an increase in payroll taxes.

Non-Regulated Revenue and Expense, Net

The major components of non-regulated income are revenue and operating expenses related to the following activities:

- operating and maintenance services (O&M) and meter reading and billing services;
- antenna site leases;
- design and construction services;
- billing of optional third-party insurance program to our residential customers;
- interest income;
- selling surplus property;
- change in cash surrender value of life insurance; and
- non-regulated and new business expenses.

Revenues from antenna site leases to telecommunication companies were $2.0 million, $2.0 million, and $1.9 million in 2013, 2012, and 2011, respectively. Revenues from the billing and marketing contract with Home Serve USA were $2.0 million in 2013, 2012, and 2011. Changes to the cash surrender value (CSV) of life insurance contracts associated with our benefit plans have had a significant impact to non-regulated expenses. There was an unrealized gain of $1.9 million in 2013, an unrealized gain of

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$2.5 million in 2012, and an unrealized loss of $1.9 million in 2011. The CSV is determined in part by the market of certain underlining funds, the value of which reflects the changes in the stock market.

In 2013, non-regulated income net of expenses decreased $1.0 million, or 33%, compared to 2012. The decrease was primarily due to a lower unrealized gain on the life insurance contracts associated with our benefit plans during 2013 and increased costs of new business opportunities. In 2012, nonregulated income net of expenses increased $2.9 million, or 1,105% compared to 2011. The increase was primarily due to an unrealized gain on the life insurance contracts associated with our benefit plans during 2012.

Gain on Sale of Non-Utility Property

For 2013, 2012, and 2011, there were no significant non-utility property sales. Earnings and cash flow from these transactions are sporadic and may or may not continue in future periods, depending upon market conditions. The Company has other non-utility properties that may be marketed in the future based on real estate market conditions.

Interest Expenses

In 2013, interest expense increased $0.7 million compared to 2012. This increase was attributable to decreased capitalized interest charged to construction projects during 2013, which was partially offset by decreased financing costs on the Company's short-term lines of credit. In 2012, interest expense decreased $1.6 million compared to 2011. This decrease was attributable to lower financing costs on the Company's short-term lines of credit, the TIRBA balancing account interest charges ending on December 31, 2011, and an increase in capitalized interest charged to construction projects during 2012.

Rates and Regulation

The following is a summary of 2013 rate filings and the anticipated annual impact on revenues. California decisions and resolutions may be found on the CPUC website at www.cpuc.ca.gov.

Type of Filing	Decision/Resolution	Approval Date	Increase (Decrease) Annual Revenue	CA District/ Subsidiary
GRC, Step Rate and Offset Filings				
Step Rate Increase	AL 2090-2092	Jan 2013	$ 9.2 million	19 districts
2013 Expense Offset	AL 2100-2104	Apr 2013	$ 3.6 million	5 districts
2013 Expense Offset	AL 2107	Jun 2013	$ 1.3 million	1 districts
2013 Expense Offset	Various(1)	Sep 2013	$ 0.8 million	5 districts
2013 Rate Base Offset	AL 2094-2095	Mar 2013	$ 0.4 million	2 districts
Surcharges and Surcredits				
Cost of Capital	AL 2088	Jan 2013	$ (3.7) million	All districts

(1) Increases result from advice letters 2110, 2111, 2112, 2113, and 2115.

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The estimated impact of current and prior year rate changes on operating revenues compared to prior years is listed in the following table:

	2013	2012	2011
	Dollars in millions		
General Rate Case (GRC)(a)	$ 1.2	$ 3.8	$ 28.1
Step rate increases	9.2	8.5	1.8
Offset (purchased water/pump taxes)	9.2	17.1	21.4
Balancing accounts, net	0.2	0.2	1.0
Other rate (decreases) increases	(6.2)	(0.7)	0.9
Total rate increases	$ 13.6	$ 28.9	$ 53.2

(a) The 2009 GRC was the first filing for all 24 districts with rate increases effective January 1, 2011. GRC activity in 2013 and 2012 includes Hawaii Water.

Water Supply

Our source of supply varies among our operating districts. Certain districts obtain all of their supply from wells; some districts purchase all of their supply from wholesale suppliers; and other districts obtain supply from a combination of wells and wholesale suppliers. A small portion of supply comes from surface sources and is processed through Company-owned water treatment plants. To the best of management's knowledge, we are meeting water quality, environmental, and other regulatory standards for all company-owned systems.

California's normal weather pattern yields little precipitation between mid-spring and mid-fall. The Washington Water service areas receive precipitation in all seasons, with the heaviest amounts during the winter. New Mexico Water's rainfall is heaviest in the summer monsoon season. Hawaii Water receives precipitation throughout the year, with the largest amounts in the winter months. Water usage in all service areas is highest during the warm and dry summers and declines in the cool winter months. Rain and snow during the winter months replenish underground water aquifers and fill reservoirs, providing the water supply for subsequent delivery to customers. To date, snowpack water content and rainfall accumulation during the 2013-2014 water year is 19% of normal (as of January 1, 2014 per the California Department of Water Resources). Precipitation in latter half of 2011 was below average. Management believes that supply pumped from underground aquifers and purchased from wholesale suppliers will be adequate to meet customer demand during 2014 and beyond. However, water rationing may be required in future periods, if declared by the state or local jurisdictions. Long-term water supply plans are developed for each of our districts to help assure an adequate water supply under various operating and supply conditions. Some districts have unique challenges in meeting water quality standards, but management believes that supplies will meet current standards using current treatment processes.

Liquidity and Capital Resources

Cash flow from Operations

During 2013, we generated cash flow from operations of $124.2 million, compared to $131.9 million during 2012, and $111.3 million during 2011. In general, cash flow from operations is primarily generated by net income, non-cash expenses for depreciation and amortization, deferred income taxes, regulatory liabilities, other current liabilities, changes of prepaid income taxes, and the amortization periods allowed by the commission to recover MCBA and other incurred costs. Cash generated by operations varies during the year. The decrease during 2013 compared to 2012 was primarily due to income tax payments of $7.7 million in 2013 compared to an income tax refund of $5.3 million in 2012. The decrease was partially offset by higher billing rates in 2013 due to the 2009 GRC. The timing of the collection from customers, the

timing of employee pensions and other benefit payments, and the timing of liability payments also impacted the decrease. The increase during 2012 compared to 2011 was primarily due to higher billing rates due to the 2009 GRC, a reduction of $10.5 million in federal and state income tax payments mostly due to the repairs and maintenance deductions, a $3.5 million reduction of the December 31, 2011 undercollected net WRAM and MCBA receivable balances due to a reduction in the amortization periods and customer usage, the timing of employee pensions and other benefit payments, and the timing of liability payments. The water business is seasonal. Billed revenue is lower in the cool, wet winter months when less water is used compared to the warm, dry summer months when water use is highest. This seasonality results in the possible need for short-term borrowings under the bank lines of credit in the event cash is not sufficient to cover operating and capital costs during the winter period. The increase in cash flow during the summer allows short-term borrowings to be paid down. Customer water usage can be lower than normal in years when more than normal precipitation falls in our service areas or temperatures are lower than normal, especially in the summer months. The reduction in water usage reduces cash flow from operations and increases the need for short-term bank borrowings. In addition, short-term borrowings are used to finance capital expenditures until long-term financing is arranged.

Investing Activities

During 2013 and 2012, we used $123.0 million and $127.7 million, respectively, of cash for capital expenditures, both company-funded and developer-funded. The 2014 budget estimated capital expenditures between $110 million and $130 million. Annual expenditures fluctuate each year due to the availability of construction resources and our ability to obtain construction permits in a timely manner.

Financing Activities

During 2013 the Company sold 5,750,000 shares of its common stock in an underwritten public offering for cash proceeds of approximately $105.6 million, net of $5.1 million of underwriting discounts and commissions and offering expenses. The net proceeds from the sale of common stock were added to our general funds to be used for general corporate purposes. In April 2013, the Company used a portion of the net proceeds from the offering to repay outstanding borrowings on the Company and Cal Water lines of credit of $68.3 million and $25.0 million, respectively. During 2012, there were no significant long-term debt or equity offerings; however, on June 29, 2011, the Company and Cal Water entered into new Syndicated Credit Agreements, which provide for unsecured revolving credit facilities of up to an initial aggregate amount of $400 million. The Syndicated Credit Facilities amend, expand, and replace the Company's and its subsidiaries' existing credit facilities originally entered into on October 27, 2009. The new credit facilities extended the terms until June 29, 2016, increased the Company's and Cal Water's unsecured revolving lines of credit, and lowered interest rates and fees. The Company and subsidiaries which it designates may borrow up to $100 million under the Company's revolving credit facility. Cal Water may borrow up to $300 million under its revolving credit facility; however, all borrowings need to be repaid within twelve months unless otherwise authorized by the CPUC. The proceeds from the revolving credit facilities may be used for working capital purposes, including the short-term financing of capital projects. The base loan rate may vary from LIBOR plus 72.5 basis points to LIBOR plus 95 basis points, depending on the Company's total capitalization ratio. Likewise, the unused commitment fee may vary from 8 basis points to 12.5 basis points based on the same ratio.

The undercollected net WRAM and MCBA receivable balances were $46.3 million and $46.1 million as of December 31, 2013 and 2012, respectively. On April 19, 2012, the CPUC issued a decision to shorten the amortization periods for Cal Water's undercollected net WRAM and MCBA receivable balances for calendar years 2013, 2012, and 2011. The increase of $0.2 million to the undercollected net WRAM and MCBA receivable balances during 2013 was due to timing of when cost-offset filings were authorized and when water production cost increases occurred in 2013. The undercollected net WRAM and MCBA receivable balances were primarily financed by Cal Water with short-term and long-term financing arrangements to meet operational cash requirements. Interest on the undercollected net WRAM and

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MCBA receivable balances, the interest recoverable from ratepayers, is limited to the current 90-day commercial paper rates which is significantly lower than Cal Water's short and long-term financing rates.

The Company borrowed $70.6 million on our bank lines of credit, repaid $113.3 million of short-term borrowings, and added $10.6 million of advances and contributions in aid of construction, which was reduced by refunds to developers of $6.9 million.

On October 4, 2011, Cal Water entered into a capital lease arrangement with the City of Hawthorne to operate the City's water system for a 15-year period. The capital lease increased debt $9.4 million during 2011.

Bond principal and other long-term debt payments were $47.2 million during 2013, compared to $7.0 million during 2012. The increase in 2013 compared to 2012 was primarily due to the $40.0 million repayment of series MMM and NNN during 2013. Bond principal and other long-term debt payments were $7.0 million during 2012 compared to $3.0 million during 2011. The increase in 2012 compared to 2011 was primarily due to the $3.7 million repayment of series GGG and HHH.

We raised the dividend rate in January 2013 to $0.640 from the 2012 rate of $0.630. The annual dividend rate has increased from $0.570 per share of common stock in 2005 to $0.640 per share of common stock in 2013.

Short-Term Financing

Short-term liquidity is provided by the bank lines of credit described above and by internally generated funds. Long-term financing is accomplished through the use of both debt and equity. As of December 31, 2013, there were short-term borrowings of $46.8 million outstanding on our unsecured revolving line of credit compared to $89.5 million outstanding on our original unsecured revolving line of credit as of December 31, 2012. The decrease during 2013 was mostly due to the repayment of the outstanding borrowings from the net cash proceeds of the Company's common stock public offerings on March 26, 2013. The increase in short-term borrowing in 2012 compared to 2011 was to finance Cal Water, Hawaii Water, and Washington Water capital projects and operating activities.

Given our ability to access our lines of credit on a daily basis, cash balances are managed to levels required for daily cash needs and excess cash is invested in short-term or cash equivalent instruments. Minimal operating levels of cash are maintained for Washington Water, New Mexico Water, and Hawaii Water.

California Water Service Group and subsidiaries which it designates may borrow up to $100 million under its new short-term credit facility. California Water Service Company may borrow up to $300 million under its new credit facility; however, all borrowings need to be repaid within twelve months unless otherwise authorized by the CPUC.

Both short-term credit agreements contain affirmative and negative covenants and events of default customary for credit facilities of this type including, among other things, limitations and prohibitions relating to additional indebtedness, liens, mergers, and asset sales. Also, these unsecured credit agreements contain financial covenants governing the Company and its subsidiaries' consolidated total capitalization ratio not to exceed 66.7% and interest coverage ratio of three or more. As of December 31, 2013, the Company's total capitalization ratio was 55.0% (trade payable is included as debt for this calculation) and interest ratio was four and three fourths. In summary, we have met all of the covenant requirements and are eligible to use the full amounts of these credit agreements.

There was $0.1 million of new debt added to long-term debt during 2013, and we made principal payments on Cal Water's first mortgage bonds and other long-term debt of $47.2 million during 2013. In 2012, there was $0.1 million of new debt added to long-term debt, and we made principal payments on Cal Water's first mortgage bonds and other long-term debt of $7.0 million.

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Long-term financing, which includes first mortgage bonds, senior notes, other debt securities, and common stock, has typically been used to replace short-term borrowings and fund capital expenditures. Internally generated funds, after making dividend payments, provide positive cash flow, but have not been at a level to meet the needs of our capital expenditure requirements. Management expects this trend to continue given our capital expenditures plan for the next five years. Some capital expenditures are funded by payments received from developers for contributions in aid of construction or advances for construction. Funds received for contributions in aid of construction are non-refundable, whereas funds classified as advances in construction are refundable. Management believes long-term financing is available to meet our cash flow needs through issuances in both debt and equity instruments.

Long-Term Financing

On January 7, 2010, Cal Water filed an application for additional financing authority with the CPUC. This request was approved on September 23, 2010, and the CPUC decision authorizes Cal Water to issue $350 million of debt and common stock to finance capital projects and operations. In November 2010, Cal Water issued $100 million of first mortgage bonds in accordance with the CPUC decision.

During 2013 the Company sold 5,750,000 shares of its common stock in an underwritten public offering for cash proceeds of approximately $105.6 million, net of $5.1 million of underwriting discounts and commissions and offering expenses. The net proceeds from the sale of common stock were added to our general funds to be used for general corporate purposes. In future periods, management anticipates funding our capital needs through a relatively balanced approach between long term debt and equity.

Additional information regarding the bank borrowings and long-term debt is presented in Notes 7 and 8 in the Notes to Consolidated Financial Statements.

Off-Balance Sheet Transactions

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

Contractual Obligations

The contractual obligations presented in the table below represent our estimates of future payments under fixed contractual obligations and commitments. Changes in our business needs, cancellation provisions and changes in interest rates, as well as action by third parties and other factors, may cause these estimates to change. Therefore, our actual payments in future periods may vary from those presented in the table below. The following table summarizes our contractual obligations as of December 31, 2013.

	Total	**Less than 1 Year**	**1 - 3 Years**	**3 - 5 Years**	**After 5 Years**
			(In thousands)		
Long-term debt(*)	$ 424,743	$ 7,693	$ 12,578	$ 42,298	$ 362,174
Interest payments	339,233	25,887	50,729	47,926	214,691
Advances for construction	183,393	7,394	14,722	14,609	146,668
Pension and post retirement benefits(**)	147,202	7,611	18,769	24,603	96,219
Capital lease obligations(***)	13,045	1,109	2,218	2,125	7,593
Facility leases	5,552	786	903	545	3,318
System leases	3,873	845	1,690	1,338	
Water supply contracts	617,085	22,560	45,333	45,546	503,646
TOTAL	$ 1,734,126	$ 73,885	$ 146,942	$ 178,990	$ 1,334,309

* Excludes capital lease obligations as reported below.

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**
Pension and post retirement benefits include $1.8 million of short-term pension obligations.

***
Capital lease obligations represent total cash payments to be made in the future and includes interest expense of $3.7 million.

Our contractual obligations are summarized in the table above. For pension and post retirement benefits other than pension obligations see Note 11 of the Notes to the consolidated Financial Statements. Long-term debt payments include annual sinking fund payments on first mortgage bonds, maturities of long-term debt, and annual payments on other long-term obligations. Advances for construction represent annual contract refunds to developers for the cost of water systems paid for by the developers. The contracts are non-interest bearing, and refunds are generally on a straight-line basis over a 40-year period. System and office leases include obligations associated with leasing water systems and rents for office space.

There are three capital leases; the most significant was the City of Hawthorne water system. In 2011, we entered into a 15-year capital lease agreement to operate the City of Hawthorne water system. The system, which is located near the Hermosa Redondo district, serves about half of Hawthorne's population. The lease agreement required us to make an up-front $8.1 million lease payment to the city that is being amortized over the lease term. Additionally, annual lease payments of $0.9 million are made to the city and shall be increased or decreased each year on July 1, by the same percentage that the rates charged to customers served by the water system increased or decreased, exclusive of pass-through increases or decreases in the cost of water, power, and city-imposed fees, compared to the rates in effect on July 1 of the prior year, provided, that in no event will the annual lease payment be less than $0.9 million. Under the lease, we are responsible for all aspects of system operation and capital improvements, although title to the system and system improvements reside with the city. In exchange, we receive all revenue from the water system, which was $7.7 million, $7.6 million, and $7.5 million in 2013, 2012, and 2011, respectively. At the end of the lease, the city is required to reimburse us for the unamortized value of capital improvements made during the term of the lease.

Cal Water has water supply contracts with wholesale suppliers in 14 of its operating districts and for the two leased systems in Hawthorne and Commerce. For each contract, the cost of water is established by the wholesale supplier and is generally beyond our control. The amount paid annually to the wholesale suppliers is charged to purchased water expense on our statement of income. Most contracts do not require minimum annual payments and vary with the volume of water purchased.

We have a contract with the Santa Clara Valley Water District, which contains minimum purchase obligations. The contract payment varies with the volume of water purchased above the minimum purchase levels. Management plans to continue to purchase and use at least the minimum quantity of water that is required to purchase under this contract in the future. Total paid to Santa Clara Valley Water District was $7.4 million in 2013, $6.2 million in 2012, and $5.5 million in 2011.

The water supply contract with Stockton East Water District (SEWD) expires on April 1, 2035, requires a fixed, annual payment and does not vary during the year with the quantity of water delivered by the district. Due to the fixed price arrangement, we utilize as much water as possible from SEWD in order to minimize the cost of operating Company-owned wells used to supplement SEWD deliveries. The total paid under the contract was $10.0 million in 2013, $6.6 million in 2012, $6.7 million in 2011. Pricing under the contract varies annually. Estimated annual contractual obligations in the above table are based on the same payment level as 2013. Future cost increases by SEWD are expected to be offset by a decline in the allocation of costs to us as more of these costs are expected to be allocated to other SEWD customers due to growth within their service areas.

On September 21, 2005, we entered into an agreement with Kern County Water Agency (Agency) to obtain treated water for our operations. The term of the agreement is to January 1, 2035, or until the Agency's bonds are repaid. The Agency's bonds are described below. Under the terms of the agreement,

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we were obligated to purchase approximately 18,500 acre feet of treated water in 2013 and an incrementally higher volume of water for each subsequent year until 2018, when we are obligated to purchase 20,500 acre feet of treated water per year. We are obligated to pay a capital facilities charge and a treated water charge regardless of whether we can use the water in our operation, and we are obligated for these charges even if the Agency cannot produce an adequate amount to supply the 20,500 acre feet in the year. This agreement supersedes a prior agreement with Kern County Water Agency for the supply of 11,500 acre feet of water per year. Total expense, under the prior agreement, was $6.3 million in 2013, $6.3 million in 2012, and $6.1 million in 2011.

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

The Agency has issued bonds to fund the project and will use the payments of the capital facilities charges by us and the other contracted parties to meet the Agency's obligations to pay interest and repay principal on the bonds. If any of the parties were to default on making payments of the capital facilities charge, then the other parties are obligated to pay for the defaulting party's share on a pro-rata basis. If there is a payment default by a party and the remaining parties have to make payments, they are also entitled to a pro-rata share of the defaulting party's water allocation.

We expect to use all of its entitled water in our operations every year. If additional treated water is available, all parties have an option to purchase this additional treated water, subject to the Agency's right to allocate the water among the parties. If we were to pay for and receive additional amounts of water due to a default of another participating party, we believe we could use this additional water in our operations without incurring substantial increases in incremental costs.

The total obligation of all parties, excluding us, is approximately $82.4 million to the Agency. Based on the credit worthiness of the other participants, which are government entities, our management believes it to be highly unlikely that we would be required to assume any other parties' obligations under the contract due to their default. If a party defaults, we would receive entitlement to the additional water for assuming the additional obligation.

We pay a capital facilities charge and charges related to treated water that together total $7.2 million annually, which equates to $352 dollars per acre foot. Total treated water charge for 2013 was $2.6 million. As treated water is being delivered, we will also be obligated for our portion of the operating costs; that portion is currently estimated to be $7 dollars per acre foot. The actual amount will vary due to variations from estimates, inflation, and other changes in the cost structure. Our overall estimated cost of $352 dollars per acre foot is less than the estimated cost of procuring untreated water (assuming water rights could be obtained) and then providing treatment.

Capital Requirements

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

Company-funded and developer-funded utility plant expenditures were $123.0 million, $127.7 million, and $118.5 million in 2013, 2012, and 2011, respectively. A majority of capital expenditures was associated with mains and water treatment equipment.

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For 2014, the Company is estimating its capital expenditures to be between $110 and $130 million. We do not expect significant increases or declines in annual capital expenditure for the next five years.

Management expects developer-funded expenditures in 2014. These expenditures will be financed by developers through refundable advances for construction and non-refundable contributions in aid of construction. Developers are required to deposit the cost of a water construction project with us prior to our commencing construction work, or the developers may construct the facilities themselves and deed the completed facilities to us. Funds are generally received in advance of incurring costs for these projects. Advances are normally refunded over a 40-year period without interest. Future payments for advances received are listed under contractual obligations above. Because non-company-funded construction activity is solely at the discretion of developers, we cannot predict the level of future activity. The cash flow impact is expected to be minor due to the structure of the arrangements.

Capital Structure

Common stockholders' equity was $598.8 million at December 31, 2013 compared to $473.7 million at December 31, 2012. In 2013, the Company sold 5,750,000 shares of its common stock in an underwritten public offering for cash proceeds of $105.6 million, net of underwriting discounts and commissions and offering expenses. In addition, the Company incurred additional long-term debt in 2013 and 2012.

Total capitalization, including the current portion of long-term debt, at December 31, 2013, was $1,033 million and $955.0 million at December 31, 2012. In future periods, the Company intends to issue common stock and long-term debt to finance our operations. The capitalization ratios will vary depending upon the method we choose to finance our operations.

At December 31, capitalization ratios were:

	2013	2012
Common equity	58.0%	49.6%
Long-term debt	42.0%	50.4%

The return (from both regulated and non-regulated operations) on average common equity was 8.8% in 2013 compared to 10.6% in 2012.

Acquisitions

In 2013, 2012, and 2011 there were no significant acquisitions.

Real Estate Program

We own real estate. From time to time, certain parcels are deemed no longer used or useful for water utility operations. Most surplus properties have a low cost basis. We developed a program to realize the value of certain surplus properties through sale or lease of those properties. The program will be ongoing for a period of several years. Property sales produced pretax gains of less than $0.1 million in 2013, 2012 and 2011. As sales are dependent on real estate market conditions, future sales, if any, may or may not be at prior year levels.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

We do not participate in hedge arrangements, such as forward contracts, swap agreements, options, or other contractual agreements to mitigate the impact of market fluctuations on our assets, liabilities, production, or contractual commitments. We operate only in the United States and, therefore, are not subject to foreign currency exchange rate risks.

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Interest Rate Risk

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

Over the next 12 months, approximately $7.9 million of the $434.0 million of existing long-term debt instruments will mature or require sinking fund payments. Applying a hypothetical 10 percent increase in the rate of interest charged on those borrowings would not have a material effect on our earnings.

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Item 8. ***Financial Statements and Supplementary Data.***

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
California Water Service Group
San Jose, California

We have audited the accompanying consolidated balance sheets of California Water Service Group and subsidiaries (the "Company") as of December 31, 2013 and 2012, and the related consolidated statements of income, common stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. We also have audited the Company's internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of California Water Service Group and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the criteria established in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ DELOITTE & TOUCHE LLP

San Francisco, California
February 27, 2014

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CALIFORNIA WATER SERVICE GROUP

Consolidated Balance Sheets

	December 31, 2013	December 31, 2012
	(In thousands, except per share data)	
ASSETS		
Utility plant:		
Land	$ 42,208	$ 42,023
Depreciable plant and equipment	2,043,414	1,903,365
Construction work in progress	109,474	132,362
Intangible assets	18,232	18,613
Total utility plant	2,213,328	2,096,363
Less accumulated depreciation and amortization	(697,497)	(639,307)
Net utility plant	1,515,831	1,457,056
Current assets:		
Cash and cash equivalents	27,506	38,790
Receivables: net of allowance for doubtful accounts of $668 and $714 in 2013 and 2012, respectively		
Customers	31,468	29,958
Regulatory balancing accounts	30,887	34,020
Other	18,700	11,943
Unbilled revenue	17,034	15,394
Materials and supplies at weighted average cost	5,571	5,874
Taxes, prepaid expenses, and other assets	8,324	10,585
Total current assets	139,490	146,564
Other assets:		
Regulatory assets	251,681	344,419
Unamortized debt premium and expense	5,114	5,591
Goodwill	2,615	2,615
Other	45,124	39,679
Total other assets	304,534	392,304
	$ 1,959,855	$ 1,995,924
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock, $0.01 par value; 68,000 shares authorized, 47,741 and 41,908, outstanding in 2013 and 2012, respectively	$ 477	$ 419
Additional paid-in capital	328,364	221,013
Retained earnings	269,915	252,280

Total common stockholders' equity	598,756	473,712
Long-term debt, less current maturities	426,142	434,467
Total capitalization	1,024,898	908,179
Current liabilities:		
Current maturities of long-term debt	7,908	46,783
Short-term borrowings	46,815	89,475
Accounts payable	55,087	47,199
Regulatory balancing accounts	1,827	5,018
Accrued other taxes	3,575	3,379
Accrued interest	4,245	4,705
Other accrued liabilities	47,127	46,508
Total current liabilities	166,584	243,067
Unamortized investment tax credits	2,106	2,180
Deferred income taxes	183,245	158,846
Regulatory liabilities	34,251	35,720
Pension and postretirement benefits other than pension	145,451	244,901
Advances for construction	183,393	187,584
Contributions in aid of construction	167,723	158,574
Other long-term liabilities	52,204	56,873
Commitments and contingencies		
	$ 1,959,855	$ 1,995,924

See accompanying Notes to Consolidated Financial Statements.

CALIFORNIA WATER SERVICE GROUP

Consolidated Statements of Income

	For the Years Ended December 31, 2013	2012	2011
	(In thousands, except per share data)		
Operating revenue	$ 584,103	$ 559,966	$ 501,814
Operating expenses:			
Operations:			
Purchased water	183,046	161,336	142,570
Purchased power	32,220	31,027	30,053
Pump taxes	10,795	10,336	9,130
Administrative and general	98,055	93,927	85,758
Other	69,738	77,104	54,696
Maintenance	17,368	19,142	20,698
Depreciation and amortization	58,320	54,668	50,385
Income taxes	19,047	19,356	23,025
Property and other taxes	21,509	19,227	18,332
Total operating expenses	510,098	486,123	434,647
Net operating income	74,005	73,843	67,167
Other income and expenses:			
Non-regulated revenue	14,795	16,686	16,160
Non-regulated expense	(11,265)	(11,553)	(15,822)
Gain on sale of non-utility property		84	62
Income tax (expense) on other income and expenses	(1,422)	(2,096)	(141)
Net other income	2,108	3,121	259
Interest expense:			
Interest expense	30,897	31,537	32,455
Less: capitalized interest	(2,038)	(3,401)	(2,741)
Net interest expense	28,859	28,136	29,714
Net income	$ 47,254	$ 48,828	$ 37,712

Earnings per share:

Basic	$ 1.02	$ 1.17	$ 0.90
Diluted	$ 1.02	$ 1.17	$ 0.90
Weighted average number of common shares outstanding:			
Basic	46,384	41,892	41,762
Diluted	46,417	41,892	41,772

See accompanying Notes to Consolidated Financial Statements.

CALIFORNIA WATER SERVICE GROUP

Consolidated Statements of Common Stockholders' Equity

For the Years Ended December 31, 2013, 2012 and 2011

	Common Stock		Additional Paid-in Capital	Retained Earnings	Total Stockholders' Equity
	Shares	Amount			
	(In thousands)				
Balance at December 31, 2010	41,667	$ 416	$ 217,309	$ 217,801	$ 435,526
Net income				37,712	37,712
Issuance of common stock	150	2	2,263		2,265
Dividends paid on common stock ($0.615 per share)				(25,674)	(25,674)
Balance at December 31, 2011	41,817	418	219,572	229,839	449,829
Net income				48,828	48,828
Issuance of common stock	91	1	1,441		1,442
Dividends paid on common stock ($0.630 per share)				(26,387)	(26,387)
Balance at December 31, 2012	41,908	419	221,013	252,280	473,712
Net income				47,254	47,254
Issuance of common stock	5,833	58	107,351		107,409
Dividends paid on common stock ($0.640 per share)				(29,619)	(29,619)
Balance at December 31, 2013	47,741	$ 477	$ 328,364	$ 269,915	$ 598,756

See accompanying Notes to Consolidated Financial Statements.

CALIFORNIA WATER SERVICE GROUP

Consolidated Statements of Cash Flows

	For the Years Ended December 31,		
	2013	2012	2011
		(In thousands)	
Operating activities:			
Net income	$ 47,254	$ 48,828	$ 37,712
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	60,250	56,866	51,981
Amortization of debt premium and expenses	1,081	1,107	1,082
Changes in deferred income taxes	9,800	34,133	2,723
Other changes in noncurrent assets and liabilities	10,244	(9,932)	(689)
Change in value of life insurance contracts	(1,878)	(2,504)	1,876
Stock-based compensation	1,832	1,442	1,300
(Gain) on sale of non-utility property		(84)	(62)
Changes in operating assets and liabilities:			
Receivables	(7,201)	(1,392)	(8,213)
Unbilled revenue	(1,640)	(326)	(1,143)
Taxes, prepaid expenses, and other assets	1,490	(3,322)	11,823
Accounts payable	3,809	879	4,612
Other current liabilities	(868)	6,219	8,270
Net cash provided by operating activities	124,173	131,914	111,272
Investing activities:			
Utility plant expenditures	(122,988)	(127,681)	(118,546)
Proceeds from sale of non-utility assets		85	64
Purchase of life insurance	(3,281)	(3,294)	(1,744)
Change in restricted cash	1,073	1,959	(3,042)
Net cash used in investing activities	(125,196)	(128,931)	(123,268)
Financing activities:			
Short-term borrowings	70,615	94,335	23,390
Repayment of short-term borrowings	(113,275)	(52,000)	
Issuance of common stock	110,688		965
Common stock issuance cost	(5,111)		
Issuance of long-term debt	48	124	178
Advances and contributions in aid of construction	10,563	6,966	7,231
Refunds of advances for construction	(6,922)	(7,397)	(6,205)
Retirement of long-term debt	(47,248)	(7,037)	(2,963)
Dividends paid	(29,619)	(26,387)	(25,674)
Net cash (used in) provided by financing activities	(10,261)	8,604	(3,078)

Change in cash and cash equivalents	(11,284)	11,587	(15,074)
Cash and cash equivalents at beginning of year	38,790	27,203	42,277
Cash and cash equivalents at end of year	$ 27,506	$ 38,790	$ 27,203
Supplemental disclosures of cash flow information:			
Cash paid (received) during the year for:			
Interest (net of amounts capitalized)	$ 28,171	$ 27,120	$ 26,998
Income taxes	7,700		10,535
Income tax refunds		(5,349)	(11,028)
Supplemental disclosure of non-cash activities:			
Accrued payables for investments in utility plant	9,932	11,048	9,008
Utility plant contributed by developers	17,329	13,630	14,991
Litigation proceeds for MTBE contamination reclassified from other long-term liabilities to CIAC	7,029	4,462	16,735
Capital leases			9,388

See accompanying Notes to Consolidated Financial Statements.

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CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements

December 31, 2013, 2012, and 2011

Amounts in thousands, except share data

1 ORGANIZATION AND OPERATIONS

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

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

Basis of Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and include the Company's accounts and those of its wholly owned subsidiaries. All intercompany transactions have been eliminated from the consolidated financial statements. In the opinion of management, the consolidated financial statements reflect all adjustments that are necessary to provide a fair presentation of the results for the periods covered.

The preparation of the Company's consolidated financial statements in accordance with GAAP 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 consolidated balance sheet dates and the reported amounts of revenues and expenses for the periods presented. These include, but are not limited to, estimates and assumptions used in determining the Company's regulatory asset and liability balances based upon probability assessments of regulatory recovery, utility plant useful lives, revenues earned but not yet billed, asset retirement obligations, allowance for doubtful accounts, pension and other employee benefit plan liabilities, and income tax-related assets and liabilities. Actual results could differ from these estimates.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenue

Revenue generally includes monthly cycle customer billings for regulated water and wastewater services at rates authorized by regulatory commissions (plus an estimate for water used between the customer's last meter reading and the end of the accounting period) and billings to certain non-regulated customers at rates authorized by contract with government agencies.

The Company's regulated water and waste water revenue requirements are authorized by the Commissions in the states in which we operate. The revenue requirements are intended to provide the Company a reasonable opportunity to recover its operating costs and earn a return on investments.

For metered customers, Cal Water recognizes revenue from rates which are designed and authorized by the California Public Utilities Commission (CPUC). Under the Water Revenue Adjustment Mechanism (WRAM), Cal Water records the adopted level of volumetric revenues, which would include recovery of cost of service and a return on investments, as established by the CPUC for metered accounts (adopted

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CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

December 31, 2013, 2012, and 2011

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2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

volumetric revenues). In addition to volumetric-based revenues, the revenue requirements approved by the CPUC include service charges, flat rate charges, and other items not subject to the WRAM. The adopted volumetric revenue considers the seasonality of consumption of water based upon historical averages. The variance between adopted volumetric revenues and actual billed volumetric revenues for metered accounts is recorded as a component of revenue with an offsetting entry to a regulatory asset or liability balancing account (tracked individually for each Cal Water district) subject to certain criteria under the accounting for regulated operations being met. The variance amount may be positive or negative and represents amounts that will be billed or refunded to customers in the future.

Cost-recovery rates are designed to permit full recovery of certain costs allowed to be recovered by the Commissions. Cost-recovery rates such as the Modified Cost Balancing Account (MCBA) provides for recovery of adopted expense levels for purchased water, purchased power and pump taxes, as established by the CPUC. In addition, cost-recovery rates include recovery of costs related to water conservation programs and certain other operating expenses adopted by the CPUC. Variances (which include the effects of changes in both rates and volumes for the MCBA) between adopted and actual costs are recorded as a component of revenue, as the amount of such variances will be recovered from or refunded to our customers at a later date. Cost-recovery expenses are generally recognized when expenses are incurred with no markup for return or profit.

The balances in the WRAM and MCBA assets and liabilities accounts will fluctuate on a monthly basis depending upon the variance between adopted and actual results. The recovery or refund of the WRAM is netted against the MCBA over- or under-recovery for the corresponding district. The recovery or refund net WRAM and MCBA balances are interest bearing at the current 90 day commercial paper rate. At the end of any calendar year, Cal Water files with the CPUC to refund or collect the balance in the accounts. Most undercollected net WRAM and MCBA receivable balances are collected over 12 or 18 months. Cal Water defers net WRAM and MCBA operating revenues and associated costs whenever the net receivable balances are estimated to be collected more than 24 months after the respective reporting periods in which it was recognized. The deferred net WRAM and MCBA revenues and associated costs were determined using forecasts of rate payer consumption trends for future reporting periods and the timing of when the CPUC will authorize Cal Water's filings to recover the undercollected balances. Deferred net WRAM and MCBA revenues and associated costs will be recognized as revenues and costs in future periods when collection is within twenty-four months of the respective reporting period.

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CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

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2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The net WRAM and MCBA balances included in regulatory assets and liabilities as of December 31, 2013 and 2012 were:

	2013	2012
Net short-term receivable	$ 30,887	$ 34,020
Net long-term receivable	15,423	12,051
Total receivable	$ 46,310	$ 46,071
Net short-term payable	$ 1,032	$ 371
Net long-term payable	906	119
Total payable	$ 1,938	$ 490

Flat rate customers are billed in advance at the beginning of the service period. The revenue is prorated so that the portion of revenue applicable to the current period is included in that period's revenue, with the remaining balance recorded as unearned revenue on the balance sheet and recognized as revenue when earned in the subsequent accounting period. The unearned revenue liability was $1,464 and $1,708 as of December 31, 2013 and 2012, respectively. This liability is included in "other accrued liabilities" on our consolidated balance sheets.

Allowance for Doubtful Accounts

The Company provides an allowance for doubtful accounts receivable. The allowance is based upon specific identified accounts plus an estimate of uncollectible accounts based upon historical percentages. The balance of customer receivables is net of the allowance for doubtful accounts at December 31, 2013, 2012, and 2011 of $668, $714, and $669, respectively.

The activities in the allowance for doubtful accounts are as follows:

	2013	2012	2011
Beginning Balance	$ 714	$ 669	$ 804
Provision for uncollectible accounts	1,469	1,548	1,250
Net write off of uncollectible accounts	(1,515)	(1,503)	(1,385)
Ending Balance	$ 668	$ 714	$ 669

Non-Regulated Revenue

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

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CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

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2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Utility Plant

Utility plant is carried at original cost when first constructed or purchased, or at fair value when acquired through acquisition. When depreciable plant is retired, the cost is eliminated from utility plant accounts and such costs are charged against accumulated depreciation. Maintenance of utility plant is charged to operating expenses as incurred. Maintenance projects are not accrued for in advance. Interest is capitalized on plant expenditures during the construction period and amounted to $2,037 in 2013, $3,401 in 2012, and $2,741 in 2011.

Intangible assets acquired as part of water systems purchased are recorded at fair value. All other intangibles have been recorded at cost and are amortized over their useful life.

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

	2013	2012
Equipment	$ 443,439	$ 400,610
Office buildings and other structures	179,023	151,597
Transmission and distribution plant	1,420,952	1,351,158
Total	$ 2,043,414	$ 1,903,365

Depreciation of utility plant for financial statement purposes is computed on a straight-line basis over the assets' estimated useful lives including cost of removal of certain assets as follows:

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

The provision for depreciation expressed as a percentage of the aggregate depreciable asset balances was 3.03% in 2013, 3.1% in 2012, and 3.0% 2011. For income tax purposes, as applicable, the Company computes depreciation using the accelerated methods allowed by the respective taxing authorities.

Asset Retirement Obligation

The Company has a legal obligation to retire wells in accordance with Department of Public Health regulations. In addition, upon decommission of a wastewater plant or lift station certain wastewater infrastructure would need to be retired in accordance with Department of Public Health regulations. An asset retirement cost and corresponding retirement obligation is recorded when a well or waste water infrastructure is placed into service. As of December 31, 2013 and 2012 the retirement obligation is estimated to be $17,036 and $16,105, respectively. The change only impacted the consolidated balance sheet.

CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

December 31, 2013, 2012, and 2011

Amounts in thousands, except share data

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash Equivalents

Cash equivalents include highly liquid investments with remaining maturities of three months or less at the time of acquisition. Cash and cash equivalents was $27.5 million and $38.8 million as of December 31, 2013 and December 31, 2012, respectively.

Restricted Cash

In 2013 restricted cash includes $1.1 million of proceeds collected through a surcharge on certain customers' bills plus interest earned on the proceeds and is used to service California Safe Drinking Water Bond obligations. All restricted cash is included in "taxes, prepaid expenses, and other assets". As of December 31, 2013 and 2012, restricted cash was $1,193 and $2,266, respectively.

Regulatory Assets and Liabilities

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

	2013	2012
Regulatory Assets		
Pension and retiree group health	$ 119,868	$ 223,153
Certain property-related temporary differences	60,780	56,991
Other accrued benefits	43,061	40,362
Net WRAM and MCBA long-term accounts receivable	15,423	12,051
Asset retirement obligations, net	12,549	11,862
Total Regulatory Assets	$ 251,681	$ 344,419

	2013	2012
Regulatory Liabilities		
Future tax benefits due ratepayers	$ 24,195	$ 24,932
Conservation program	6,291	6,538
Other liabilities	3,765	4,250
Total Regulatory Liabilities	$ 34,251	$ 35,720

Short-term regulatory assets and liabilities are excluded from the above table. The short-term regulatory assets for 2013 and 2012 were $30,887 and $34,020, respectively. The short-term regulatory assets were primarily net WRAM/MCBA receivable balances. The short-term portion of regulatory liabilities for 2013 and 2012 were $1,827 and $5,018, respectively. The short-term regulatory liabilities were primarily net WRAM/MCBA liability balances and net refund balances to rate payers for the 2007 sale of the Extended Service Protection program to Home

Service USA

The Company operates extensively in a regulated business, and as such is subject to the accounting standards for regulated utilities. Utility companies defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that those costs and credits will be recognized in the ratemaking process in a period different from the period in which they would have been reflected in income by an unregulated company. Regulatory assets other than WRAM represent deferral of costs that

CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

December 31, 2013, 2012, and 2011

Amounts in thousands, except share data

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

will be recovered in the future and do not include a return. In determining the probability of costs being recognized in other periods, the Company considers regulatory rules and decisions, past practices, and other facts or circumstances that would indicate if recovery is probable. In the event that a portion of the Company's operations were no longer subject to the accounting standards for regulated utilities, the Company would be required to write off related regulatory assets and liabilities. If a commission determined that a portion of the Company's assets were not recoverable in customer rates, the Company would be required to determine if a disallowance of asset costs had occurred. If a disallowance had occurred, it would require a write-down in the assets' valuation.

The Company's qualified, defined-benefit, non-contributory pension plan and other postretirement plan benefit (Retire Group Health) regulatory asset is the amount the Company expects to recover from ratepayers in the future for these plans at the end of the calendar year.

The certain property-related temporary differences relate primarily to the difference between book and federal income tax depreciation on utility plant that was placed in service before the regulatory Commissions adopted normalization for rate making purposes. Previously, the tax benefit of tax depreciation was passed on to customers (flow-through). For state income tax purposes, the Commission continues to use the flow-through method. As such timing differences reverse, the Company will be able to include the impact of such differences in customer rates. These federal tax differences will continue to reverse over the remaining book lives of the related assets.

Other accrued benefits are accrued benefits for vacation, self-insured workers' compensation, and directors' retirement benefits. The net WRAM and MCBA long-term accounts receivable is the undercollected portion of recorded revenues that are not expected to be collected from ratepayers within 12 months. The asset retirement obligation regulatory asset represents the difference between costs associated with asset retirement obligations and amounts collected in rates.

The future tax benefits due to ratepayers represent regulatory liabilities for tax deductions that will be taken and flowed through to customers in the future. Regulatory liabilities also reflect timing differences provided at higher than the current tax rate, which will flow-through to future ratepayers. The conservation program regulatory liability is for cost recovery in rates that exceeded incurred costs and is refundable to ratepayers as of December 31, 2013.

Impairment of Long-Lived Assets, Intangibles and Goodwill

The Company regularly reviews its long-lived assets, intangible assets and goodwill for impairment annually or when events or changes in business circumstances have occurred that indicate the carrying amount of such assets may not be fully realizable. Potential impairment of assets held for use is determined by comparing the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying value of the asset exceeds its fair value.

Goodwill is measured as the excess of the cost of an acquisition over the sum of the amounts assigned to identifiable assets acquired less liabilities assumed. Goodwill and other identifiable intangible assets are accounted for in accordance with generally accepted accounting principles. Goodwill is not amortized but

CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

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2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

instead is reviewed annually at November 30th for impairment or more frequently if impairment indicators arise.

The impairment test is performed at the reporting unit level using a two-step, fair-value based approach. The first step determines the fair value of the reporting unit and compares it to the reporting unit's carrying value. If the fair value of the reporting unit is less than its carrying amount, a second step is performed to measure the amount of impairment loss, if any. The second step allocates the fair value of the reporting unit to the Company's tangible and intangible assets and liabilities. This derives an implied fair value for the reporting unit's goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized equal to the excess.

The recorded goodwill balance as of December 31, 2013 and 2012, relate to the Hawaii Water Service Company reporting unit. Based on our annual goodwill impairment test, no impairment was recorded in 2013 or 2012.

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 on a straight-line basis which approximates the effective interest method. Premiums paid on the early redemption of certain debt and the unamortized original issuance discount and expense are amortized over the life of new debt issued in conjunction with the early redemption. Amortization expense included in interest expense was $1,081, $1,107, and $1,082 for 2013, 2012, and 2011, respectively.

Advances for Construction

Advances for Construction consist of payments received from developers for installation of water production and distribution facilities to serve new developments. Advances are excluded from rate base for rate setting purposes. Annual refunds are made to developers without interest. Advances of $182,776, and $186,753 at December 31, 2013 and 2012, respectively, will be refunded primarily over a 40-year period in equal annual amounts. In addition, other Advances for Construction totaling $617 and $831 at December 31, 2013, and 2012, respectively, are refundable based upon customer connections. Estimated refunds of advances for each succeeding year are approximately $7,394, $7,392, $7,330, $7,313, $7,296 and $146,668 thereafter.

Contributions in Aid of Construction

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

Income Taxes

The Company accounts for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial

CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

December 31, 2013, 2012, and 2011

Amounts in thousands, except share data

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

Historically the Commissions reduced revenue requirements for the tax effects of certain originating temporary differences and allowed recovery of these tax costs as the related temporary differences reverse. The Commissions have granted the Company rate increases to reflect the normalization of the tax benefits of the federal accelerated methods and available Investment Tax Credits (ITC) for all assets placed in service after 1980. ITCs are deferred and amortized over the lives of the related properties for book purposes. The commissions granted flowthrough for state taxes.

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 contributions of fire services from taxable income.

The accounting standards for accounting for uncertainty in income taxes allows the inclusion of interest and penalties related to uncertain tax positions as a component of income taxes. See note 10 "Income Taxes".

Workers' Compensation, General Liability and Other Claims

For workers' compensation, the Company estimates the liability associated with claims submitted and claims not yet submitted based on historical data. Expenses for workers compensation insurance are included in rates on a pay-as-you-go basis. Therefore, a corresponding regulatory asset has been recorded. For general liability claims and other claims, the Company estimates the cost incurred but not yet paid using historical information.

Collective Bargaining Agreements

As of December 31, 2013, the Company had 1,125 employees, including 703 non-supervisory employees who are represented by the Utility Workers Union of America, AFL-CIO, except certain engineering and laboratory employees who are represented by the International Federation of Professional and Technical Engineers, AFL-CIO. The union agreements expire at the end of 2014.

Earnings Per Share

The computations of basic and diluted earnings per share are noted below. Basic earnings per share are computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts were exercised or converted into common stock. Restricted Stock Awards (RSAs) are included in the common shares outstanding because the shares have all the same voting and dividend rights as issued and unrestricted common stock.

CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

December 31, 2013, 2012, and 2011

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2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Company did not grant any Stock Appreciation Rights (SAR) in 2013, 2012, and 2011. SARs outstanding were 283,856 shares as of December 31, 2013, 333,856 as of December 31, 2012 and 361,356 shares as of December 31, 2011.

All SARs are dilutive. The dilutive effect is shown in the table below.

	2013	2012	2011
		(In thousands, except per share data)	
Net income as reported and available to common stockholders	$ 47,254	$ 48,828	$ 37,712
Weighted average common shares, basic	46,384	41,892	41,762
Dilutive common stock equivalents (treasury method)	33		10
Shares used for dilutive calculation	46,417	41,892	41,772
Earnings per share basic	$ 1.02	$ 1.17	$ 0.90
Earnings per share diluted	$ 1.02	$ 1.17	$ 0.90

Stock-based Compensation

The Company follows accounting standards for stock-based compensation. Compensation cost is measured at the grant date based on the fair value of the award. The Company recognizes compensation as expense on a straight-line basis over the requisite service period, which is the vesting period.

Comprehensive Income or Loss

Comprehensive income for all periods presented was the same as net income.

Accumulated Other Comprehensive Income

The Company did not have any accumulated other comprehensive income or loss transactions for 2013, 2012, and 2011.

Adoption of New Accounting Standards

On February 1, 2013, the Financial Accounting Standards Board issued an accounting standards update (ASU) for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements. The ASU would impact the Company's recognition, measurement, and disclosure requirements for guarantees of third party debt. The ASU effective date for the Company's interim and annual reporting is January 1, 2014. The Company completed a review of all contracts and did not identify any joint and several liability arrangements.

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CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

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3 OTHER INCOME AND EXPENSES

The Company conducts various non-regulated activities as reflected in the table below.

	2013		2012		2011	
	Revenue	Expense	Revenue	Expense	Revenue	Expense
Operating and maintenance	$ 8,028	$ 9,119	$ 9,938	$ 10,976	$ 9,176	$ 9,689
Meter reading and billing	1,313	1,055	1,255	882	1,212	944
Leases	1,938	243	1,956	153	1,892	330
Design and construction	1,374	1,173	1,407	1,135	1,689	1,420
Interest income	70		41		75	
Change in value of life insurance contracts (gain) loss		(1,878)		(2,504)		1,876
Other non-regulated income and expenses	2,072	1,553	2,089	911	2,116	1,563
Total	$ 14,795	$ 11,265	$ 16,686	$ 11,553	$ 16,160	$ 15,822

Operating and maintenance services and meter reading and billing services are provided for water and wastewater systems owned by private companies and municipalities. The agreements call for a fee-per-service or a flat-rate amount per month. Leases have been entered into with telecommunications companies for cellular phone antennas placed on the Company's property. Design and construction services are for the design and installation of water mains and other water infrastructure for others outside the Company's regulated service areas. Third-party insurance program revenues are included in other non-regulated income and expenses.

4 INTANGIBLE ASSETS

As of December 31, 2013 and 2012, intangible assets that will continue to be amortized and those not amortized were:

	Weighted Average Amortization Period (years)	2013			2012		
		Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Amortized intangible assets:							
Water pumping rights	usage	$ 1,084	$ 85	$ 999	$ 1,084	$ 79	$ 1,005
Water planning studies	11	12,567	5,517	7,040	11,894	4,322	7,572
Leasehold improvements and other	22	1,191	411	780	1,140	249	891
Total	12	$ 14,842	$ 6,013	$ 8,829	$ 14,118	$ 4,650	$ 9,468

Unamortized intangible assets:						
Perpetual water rights and other	$ 3,390	$	$ 3,390	$ 4,495	$	$ 4,495

Water pumping rights usage is the amount of water pumped from aquifers to be treated and distributed to customers.

For the years ended December 31, 2013, 2012, and 2011, amortization of intangible assets was $1,354, $1,298, and $1,421, respectively. Estimated future amortization expense related to intangible assets for the succeeding five years is approximately $1,385, $1,333, $1,310, $1,280, 1,248, and $2,452 thereafter.

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5 PREFERRED STOCK

The Company is authorized to issue 241,000 shares of Preferred Stock as of December 31, 2013. No shares of Preferred Stock were issued and outstanding at December 31, 2013 or 2012.

6 COMMON STOCKHOLDERS' EQUITY

As of December 31, 2013 and 2012, 47,740,957 shares and 41,908,218 shares, respectively, of common stock were issued and outstanding. In 2013, the Company sold 5,750,000 shares of its common stock in an underwritten public offering.

Dividend Reinvestment and Stock Repurchase Plan

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

7 SHORT-TERM BORROWINGS

On June 29, 2011, the Company and Cal Water entered into Syndicated Credit Agreements, which provide for unsecured revolving credit facilities of up to an initial aggregate amount of $400 million. The Syndicated Credit Facilities amend, expand, and replace the Company's and its subsidiaries' existing credit facilities originally entered into on October 27, 2009. The new credit facilities extended the terms until June 29, 2016, increased the Company's and Cal Water's unsecured revolving lines of credit, and lowered interest rates and fees. The Company and subsidiaries which it designates may borrow up to $100 million under the Company's revolving credit facility. Cal Water may borrow up to $300 million under its revolving credit facility; however, all borrowings need to be repaid within twelve months unless otherwise authorized by the CPUC. The proceeds from the revolving credit facilities may be used for working capital purposes, including the short-term financing of capital projects. The base loan rate may vary from LIBOR plus 72.5 basis points to LIBOR plus 95 basis points, depending on the Company's total capitalization ratio. Likewise, the unused commitment fee may vary from 8 basis points to 12.5 basis points based on the same ratio.

Both short-term unsecured credit agreements contain affirmative and negative covenants and events of default customary for credit facilities of this type including, among other things, limitations and prohibitions relating to additional indebtedness, liens, mergers, and asset sales. Also, these unsecured credit agreements contain financial covenants governing the Company and its subsidiaries' consolidated total capitalization ratio and interest coverage ratio.

As of December 31, 2013 and December 31, 2012, the outstanding borrowings on the Company lines of credit were $16.8 million and $64.5 million, respectively. The borrowings on the Cal Water lines of credit were $30.0 million as of December 31, 2013, and $25.0 million as of December 31, 2012.

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7 SHORT-TERM BORROWINGS (Continued)

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

	2013	2012
Maximum short-term borrowings	$ 91,975	$ 89,475
Average amount outstanding	$ 42,589	$ 71,715
Weighted average interest rate	2.00%	1.74%
Interest rate at December 31	1.33%	2.14%

8 LONG-TERM DEBT

As of December 31, 2013 and 2012, long-term debt outstanding was:

	Series	Interest Rate	Maturity Date	2013	2012
First Mortgage Bonds	PPP	5.500%	2040	$ 100,000	$ 100,000
	LL	5.875%	2019	100,000	100,000
	AAA	7.280%	2025	20,000	20,000
	BBB	6.770%	2028	20,000	20,000
	CCC	8.150%	2030	20,000	20,000
	DDD	7.130%	2031	20,000	20,000
	EEE	7.110%	2032	20,000	20,000
	FFF	5.900%	2017	20,000	20,000
	GGG	5.290%	2022	16,364	18,182
	HHH	5.290%	2022	16,364	18,182
	III	5.540%	2023	9,091	10,000
	JJJ	5.440%	2018	4,545	5,455
	LLL	5.480%	2018	10,000	10,000
	MMM	5.520%	2013		20,000
	NNN	5.550%	2013		20,000
	OOO	6.020%	2031	20,000	20,000
	CC	9.860%	2020	17,300	17,400
	K	6.940%	2012		
Total First Mortgage Bonds				413,664	459,219
California Department of Water Resources Loans		2.6% to 8%	2012 - 32	8,008	8,451
Other Long-term debt				12,378	13,580
Total long-term debt				434,050	481,250
Less current maturities				7,908	46,783
Long-term debt excluding current maturities				$ 426,142	$ 434,467

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8 LONG-TERM DEBT (Continued)

On October 4, 2011, Cal Water entered into a new capital lease arrangement with the City of Hawthorne to operate the City's water system for a 15-year period. The $9.2 million capital lease liability is included in other long-term debt and current maturities set forth above.

9 OTHER ACCRUED LIABILITIES

As of December 31, 2013 and 2012, other accrued liabilities were:

	2013	2012
Accrued and deferred compensation	$ 18,493	$ 16,320
Deferred tax liability	12,224	15,000
Accrued benefit and workers' compensation claims	8,140	6,906
Other	8,270	8,282
	$ 47,127	$ 46,508

The deferred compensation program allows key employees and board of directors to defer a portion of their compensation from income taxes. The deferred compensation liability balances were $6,033 and $4,650 as of December 31, 2013 and 2012, respectively.

10 INCOME TAXES

Income tax expense (benefit) consisted of the following:

	Federal	State	Total
2013			
Current	$ 7,974	$ (2,867)	$ 5,107
Deferred	15,667	(305)	15,362
Total	$ 23,641	$ (3,172)	$ 20,469
2012			
Current	$ (9,018)	$ (5,246)	$ (14,264)
Deferred	37,196	(1,480)	35,716
Total	$ 28,178	$ (6,726)	$ 21,452

2011			
Current	$ 7,413	$ 2,629	$ 10,042
Deferred	12,982	142	13,124
Total	$ 20,395	$ 2,771	$ 23,166

In 2013, the Company recorded $4.4 million of State of California enterprise zone (EZ) credits for sales and use taxes and hiring incentives for the period from 2008 to 2013 based on an analysis of all district operations. The Company filed amended state income tax returns for tax years 2008, 2009, 2010 and 2011. The State of California hiring EZ credits were included on the Company's 2012 state income tax

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10 INCOME TAXES (Continued)

returns filed during the fourth quarter of 2013. The 2012 sales and use tax EZ credits will be filed on an amended 2012 state income tax return during 2014. Unused State of California EZ credits can be carried-forward ten years. The Company estimates the carried-forward portion of its State of California EZ credits at $2.3 million. The Company's analysis of State of California EZ credits as of December 31, 2013 resulted in the recognition of a $0.6 million liability for unrecognized tax benefits.

On September 19, 2013, the U. S. Department of the Treasury and Internal Revenue Service (IRS) issued the final and re-proposed tangible property regulations for repairs and maintenance deductions with an effective date of January 1, 2014. These tax regulations allowed the Company to deduct a significant amount of linear asset costs previously capitalized for book and tax purposes. The Company intends to reevaluate its unit of property for linear assets on its 2013 tax return. The Company's federal fourth quarter of 2013 qualified repairs and maintenance deductions was $25.0 million for 2012 and prior years and created a deferred income tax liability $8.8 million as of December 31, 2013. The Company's state fourth quarter of 2013 qualified repairs and maintenance deductions was $41.0 million for 2012 and prior years and was recorded as a $2.4 million reduction to state income tax expense. The total federal NOL was $14.8 million and state NOL was $42.0 million as of December 31, 2013 mostly due to repairs and maintenance deductions. The NOL carry-forward amounts are more likely than not to be recovered and therefore require no valuation allowance. The NOL carry-forward does not begin to expire until 2033.

During 2012, the Company filed an application for a change in tax accounting method with the IRS to implement the repairs and maintenance deduction. The Company's federal linear assets qualified repairs and maintenance deduction was $86.7 million for 2011 and prior years, and created a $30.4 million deferred income tax liability as of December 31, 2012. The Company's state linear assets qualified repairs and maintenance deduction was $122.2 million for 2011 and prior years and was recorded as a $7.0 million reduction to state income tax expense. The Company planned to carry-back the NOL as of December 31, 2012 and recorded a $0.8 million federal income tax expense. This adjustment was reversed in 2013 when the federal NOL was carried-forward to reduce 2013 income tax payments.

The American Taxpayer Relief Act of 2012 provided the Company with additional 50% first-year bonus depreciation for assets placed in service from December 31, 2012 to December 31, 2013. The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 provided the Company with additional federal income tax deductions for assets placed in service after September 8, 2010 and before December 31, 2012. The federal income tax deduction was estimated at $2.1 million in 2013, was $5.1 million in 2012, and was $12.6 million in 2011. The 2013 estimate will be finalized when we file the 2013 tax returns in the third quarter of 2014. As of December 31, 2013 and 2012 the deferred tax liability for bonus depreciation was $2,100 and $5,000, respectively.

The Company filed an application for a change in tax accounting method with the State of California to change its plant-in-service state tax depreciation method from the double- declining method to the straight line method at the respective assets mid-life. The Company's application was approved by the State of California during the first quarter of 2011. California uses the flow-through method of accounting for income tax depreciation. As a result, the Company reduced its income tax obligation $1.6 million, net of federal income taxes in 2011. Income tax expense was computed by applying the current federal 35% tax rate to pretax book income differs from the amount shown in the Consolidated Statements of Income.

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Notes to Consolidated Financial Statements (Continued)

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10 INCOME TAXES (Continued)

The difference between the total income tax expense and computed tax expense was reconciled in the table below:

	2013	2012	2011
Computed "expected" tax expense	$ 23,708	$ 24,600	$ 21,308
Increase (reduction) in taxes due to:			
State income taxes net of federal tax benefit	3,895	4,041	3,500
Effect of regulatory treatment of fixed asset differences	(4,112)	(7,030)	(1,614)
State tax credits	(2,465)		
Investment tax credits	(74)	(74)	(74)
Other	(483)	(85)	46
Total income tax	$ 20,469	$ 21,452	$ 23,166

The effect of regulatory treatment of fixed asset differences includes a 2013 tax accounting method change benefit of ($3,061) due to the service mains and hydrant tax repairs and maintenance deductions for 2012 and prior years. The 2012 tax accounting method change was a benefit of ($7,030) due to the transmission and distribution mains tax repairs and maintenance deductions for 2011 and prior years. The 2011 section 481 adjustment was a benefit of ($1,614) due to an accounting method change with the State of California to change its plant-in-service state tax depreciation method from the double- declining method to the straight line method at the respective assets mid-life.

The tax effects of differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2013 and 2012 are presented in the following table:

	2013	2012
Deferred tax assets:		
Developer deposits for extension agreements and contributions in aid of construction	$ 44,592	$ 44,530
Net operating loss carryforward and tax credits	9,095	8,437
Other	4,330	3,607
Total deferred tax assets	58,017	56,574
Deferred tax liabilities:		
Utility plant, principally due to depreciation differences	231,141	207,642
WRAM/MCBA balancing accounts	18,556	19,533
Other	3,789	3,245
Total deferred tax liabilities	253,486	230,420

Net deferred tax liabilities	$	195,469	$	173,846

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CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

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10 INCOME TAXES (Continued)

The current portion of our deferred income tax liability is $12,224 and $15,000 as of December 31, 2013 and 2012, respectively, which includes prepaid expenses and billed WRAM/MCBA surcharge, expected to reverse in the following 12 months.

A valuation allowance was not required at December 31, 2013 and 2012. Based on historical taxable income and future taxable income projections over the period in which the deferred assets are deductible, management believes it is more likely than not that the Company will realize the benefits of the deductible differences.

The following table reconciles the changes in unrecognized tax benefits:

	December 31, 2013	December 31, 2012	December 31, 2011
Balance at beginning of year	$	$ 831	$ 831
Additions for tax positions taken during prior year			
Additions for tax positions taken during current year	612		
Reductions for tax positions taken during a prior year			
Lapse of statute of limitations		(831)	
Balance at end of year	$ 612	$	$ 831

As of December 31, 2013 and 2012, the total amount of net unrecognized tax benefits was $612 and none, respectively. The Company accrues interest and penalties related to unrecognized tax benefits in its provision for income taxes. The total accrued penalties and interest of $114 was reversed as of December 31, 2012 and the total amount of penalties and interest was $114 as of December 31, 2011. Additionally, the Company does not expect a material change in its unrecognized tax benefits within the next 12 months.

Tax years of 2013 and 2012 are subject to examination by federal taxing authorities and 2013, 2012, 2011, and 2010 are subject to examination by state taxing authorities. On October 24, 2013, the IRS completed its audit of the Company's 2010 and 2011 federal income tax returns with no audit adjustment. In December 2012, the California Franchise Tax Board completed an audit of the Company's 2008 and 2009 state income tax returns with no audit adjustment. The State of Hawaii Department of Taxation is presently auditing the Company's 2011 and 2012 Hawaii state income tax returns. The State of California Board of Equalization Franchise is presently auditing the Company's 2010, 2011, and 2012 sales and use tax filings. It is uncertain when the State audits will be completed. The Company believes that the final resolution of the state audits will not have a material impact on its financial condition or results of operations.

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Notes to Consolidated Financial Statements (Continued)

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11 EMPLOYEE BENEFIT PLANS

Savings Plan

The Company sponsors a 401(k) qualified, defined contribution savings plan that allows participants to contribute up to 20% of pre-tax compensation. Effective January 1, 2010, the Company matches seventy-five cents for each dollar contributed by the employee up to a maximum Company match of 6.0% of base salary. In the prior year, the Company matched fifty cents for each dollar contributed up to a maximum Company match of 4.0% of base salary. Company contributions were $4,338, $4,029, and $3,499, for the years 2013, 2012, and 2011, respectively.

Pension Plans

The Company provides a qualified, defined-benefit, non-contributory pension plan for substantially all employees. The accumulated benefit obligations of the pension plan are $287,894 and $307,197 as of December 31, 2013 and 2012, respectively. The fair value of pension plan assets was $266,178 and $202,947 as of December 31, 2013 and 2012, respectively.

Prior to 2010, pension payment obligations were generally funded by the purchase of an annuity from a life insurance company. In 2010, the pension plan trust paid monthly benefits to retirees, rather than the purchase of an annuity. Payments are expected to be made in each year from 2014 to 2018 are $7,611, $8,703, $10,066, 11,539, and $13,064, respectively. The aggregate benefits expected to be paid in the five years 2019 through 2023 are $91,303. The expected benefit payments are based upon the same assumptions used to measure the Company's benefit obligation at December 31, 2013, and include estimated future employee service.

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Notes to Consolidated Financial Statements (Continued)

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11 EMPLOYEE BENEFIT PLANS (Continued)

The Company also maintains an unfunded, non-qualified, supplemental executive retirement plan. The unfunded supplemental executive retirement plan accumulated benefit obligations were $31,360 and $31,696 as of December 31, 2013 and 2012, respectively. Benefit payments under the supplemental executive retirement plan are paid currently and are included in the preceding paragraph.

The costs of the pension and retirement plans are charged to expense and utility plant. The Company makes annual contributions to fund the amounts accrued for pension cost.

Other Postretirement Plan

The Company provides substantially all active, permanent employees with medical, dental, and vision benefits through a self-insured plan. Employees retiring at or after age 58, along with their spouses and dependents, continue participation in the plan by payment of a premium. Plan assets are invested in mutual funds, short-term money market instruments and commercial paper based upon the same asset mix as the pension plan. Retired employees are also provided with a five thousand dollar life insurance benefit.

The Company records the costs of postretirement benefits other than pension (PBOP) during the employees' years of active service. Postretirement benefit expense recorded in 2013, 2012, and 2011, was $8,977, $8,131, and $6,291, respectively. The remaining net periodic benefit cost was $9,790 at December 31, 2006, and is being recovered through future customer rates and is recorded as a regulatory asset. The expected benefit payments, net of retiree premiums and Medicare part D subsidies, for the years from 2014 to 2018 are $1,612, $1,827, $1,998, $2,189, and $2,444, respectively. The Medicare Part D subsidies for the years from 2014 to 2018 are $267, $307, $345, $387, and $432.

Benefit Plan Assets

The Company actively manages pensions and PBOP trust (Plan) assets. The Company's investment objectives are:

- Maximize the return on the assets of the Plan, commensurate with the risk that the Company deem appropriate to, meet the obligations of the Plan, minimize the volatility of the pension expense, and account for contingencies;

- Generate a rate of return for the total portfolio that equals or exceeds the actuarial investment rate assumption;

- Additionally, the rate of return of the total fund shall be measured periodically against a special index comprised of 35% of the Standard & Poor's Index, 15% of the Russell 2000 Index, 10% of the MSCI EAFE Index, and 40% of the Lehman Aggregate Bond Index. The special index is consistent with the rate of return objective and indicates the Company's long-term asset allocation objective.

The Company applies a risk management framework for managing the risks associated with employee benefit plan trust assets. The guiding principles of this risk management framework are the clear articulation of roles and responsibilities, appropriate delegation of authority, and proper accountability and documentation. Trust investment policies and investment manager guidelines include provisions to

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11 EMPLOYEE BENEFIT PLANS (Continued)

ensure prudent diversification, manage risk through appropriate use of physical direct asset holdings and derivative securities, and identify permitted and prohibited investments.

The Company's target asset allocation percentages for major categories of the pension plan are reflected in the table below:

	Minimum Exposure	Target	Maximum Exposure
Fixed Income	35%	40%	45%
Total Domestic Equity	40%	50%	60%
Small Cap Stocks	10%	15%	20%
Large Cap Stocks	30%	35%	45%
Non-U.S. Equities	5%	10%	15%

The fixed income category includes money market funds, short-term bond funds, and cash. The majority of fixed income investments range in maturities from less than one to five years.

The Company's target allocation percentages for the PBOP trust is similar to the pension plan except for a larger allocation in fixed income investments and a lower allocation in equity investments.

We use the following criteria to select investment funds:

Fund past performance;

Fund meets criteria of Employee Retirements Income Security Act (ERISA);

Timeliness and completeness of fund communications and reporting to investors;

Stability of fund management company;

Fund management fees; and

Administrative costs incurred by the Plan.

The fair value measurements standard establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under the standard are described below:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Plan has the ability to access.

Level 2 Inputs to the valuation methodology include:

- Quoted market prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability; and

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11 EMPLOYEE BENEFIT PLANS (Continued)

Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

All Plan investments are level 1 investments in mutual funds and are valued at the net asset value (NAV) of the shares held by the Plan at December 31, 2013 and 2012:

	Pension Benefits				Other Benefits			
	2013	**%**	**2012**	**%**	**2013**	**%**	**2012**	**%**
Fixed Income	$ 102,288	38%	$ 79,391	39%	$ 31,019	62%	$ 22,845	61%
Domestic Equity								
Small Cap Stocks	40,757		33,949					
Large Cap Stocks	96,512		69,406		18,920		14,563	
Total Domestic Equity	137,269	52%	103,355	51%	18,920	38%	14,563	39%
Non U.S. Equities	26,621	10%	20,201	10%		0%		0%
Total Plan Assets	$ 266,178	100%	$ 202,947	100%	$ 49,939	100%	$ 37,408	100%

The pension benefits fixed income category includes $1,287 and $26,069 of money market fund investments as of December 31, 2013 and 2012, respectively. The other benefits fixed income category includes $19,214 and $14,159 of money market fund investments as of December 31, 2013 and 2012.

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11 EMPLOYEE BENEFIT PLANS (Continued)

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, 2013 and 2012:

	Pension Benefits		Other Benefits	
	2013	2012	2013	2012
Change in projected benefit obligation:				
Beginning of year	$ 402,121	$ 346,305	$ 84,421	$ 69,107
Service cost	17,780	15,450	5,374	4,399
Interest cost	16,354	15,287	3,556	3,139
Assumption change	(53,887)	24,269	(14,366)	7,673
Experience loss	6,021	4,833	1,455	1,250
Benefits paid, net of retiree premiums	(5,191)	(4,023)	(1,374)	(1,147)
End of year	$ 383,198	$ 402,121	$ 79,066	$ 84,421
Change in plan assets:				
Fair value of plan assets at beginning of year	$ 202,947	$ 155,749	$ 37,408	$ 26,978
Actual return on plan assets	36,637	21,979	4,270	2,788
Employer contributions	31,785	29,242	9,635	8,789
Retiree contributions and Medicare part D subsidies			1,299	1,255
Benefits paid	(5,191)	(4,023)	(2,673)	(2,402)
Fair value of plan assets at end of year	$ 266,178	$ 202,947	$ 49,939	$ 37,408
Funded status(1)	$ (117,020)	$ (199,174)	$ (29,127)	$ (47,013)
Unrecognized actuarial loss	53,882	133,579	23,311	40,449
Unrecognized prior service cost	36,116	41,972	340	421
Unrecognized transition obligation				9
Net amount recognized	$ (27,022)	$ (23,623)	$ (5,476)	$ (6,134)

(1) The short-term portion of the pension benefits was $1,751 and $1,286 as of December 31, 2013 and 2012, respectively.

Amounts recognized on the balance sheet consist of:

	Pension Benefits		Other Benefits	
	2013	2012	2013	2012
(Accrued) benefit costs	$	$	$ (6,219)	$ (6,723)
Accrued benefit liability	(117,020)	(199,174)	(29,127)	(47,013)
Regulatory asset	89,998	175,551	29,870	47,602
Net amount recognized	$ (27,022)	$ (23,623)	$ (5,476)	$ (6,134)

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Notes to Consolidated Financial Statements (Continued)

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11 EMPLOYEE BENEFIT PLANS (Continued)

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

	Pension Benefits		Other Benefits	
	2013	**2012**	**2013**	**2012**
Weighted average assumptions as of December 31:				
Discount rate	5.00%	4.10%	5.00%	4.20%
Long-term rate of return on plan assets	6.75%	7.00%	6.00%	6.00%
Rate of compensation increases	4.00%	3.50%		
Cost of living adjustment	3.00%	3.00%		

The discount rate was derived from the Citigroup Pension Discount Curve using the expected payouts for the plan. The long-term rate of return assumption is the expected rate of return on a balanced portfolio invested roughly 60% in equities and 40% in fixed income securities. Returns on equity investments were estimated based on estimates of dividend yield and real earnings added to a 3% long-term inflation rate. For the pension and other benefit plans, the assumed returns were 8.93% for domestic equities and 9.07% for foreign equities. Returns on fixed-income investments were projected based on investment maturities and credit spreads added to a 3% long-term inflation rate. For the pension and other benefit plans, the assumed returns were 5.20% for fixed income investments and 3.52% for short-term cash investments. The average return for the pension and other benefit plans for the last five and ten years was 11.4% and 6.9%, respectively. The company is using a long-term rate of return of 6.75% for the pension plan and 6.00% for the other benefit plan, which is between the 25th and 75th percentile of expected results.

Changes to the pension benefits actuarial assumptions can significantly affect pension costs, regulatory assets, and liabilities. The following table reflects the sensitivity of pension amounts reported for the year ended December 31, 2013, to changes in actuarial assumptions:

	Increase/(Decrease) in Pension Actuarial Assumption	Increase/(Decrease) in 2013 Net Periodic Pension Benefit Cost	Increase/(Decrease) in Projected Pension Benefit Obligation as of December 31, 2013
Discount rate	(0.5)%	$ 4,899	$ 35,752
Long-term rate of return on plan assets	(0.5)%	1,018	
Rate of compensation increases	(0.5)%	(2,181)	(10,186)
Cost of living adjustment	(0.5)%	(3,685)	(22,029)
Discount rate	0.5%	(4,334)	(31,486)
Long-term rate of return on plan assets	0.5%	(1,018)	
Rate of compensation increases	0.5%	2,364	10,908

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CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

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11 EMPLOYEE BENEFIT PLANS (Continued)

Net periodic benefit costs for the pension and other postretirement plans for the years ended December 31, 2013, 2012, and 2011 included the following components:

	Pension Plan			Other Benefits		
	2013	2012	2011	2013	2012	2011
Service cost	$ 17,780	$ 15,450	$ 11,713	$ 5,374	$ 4,399	$ 3,199
Interest cost	16,354	15,287	14,683	3,556	3,139	2,872
Expected return on plan assets	(14,252)	(11,558)	(8,949)	(2,394)	(1,832)	(1,372)
Net amortization and deferral	15,302	14,283	10,387	2,441	2,425	1,592
Net periodic benefit cost	$ 35,184	$ 33,462	$ 27,834	$ 8,977	$ 8,131	$ 6,291

Below are the actuarial assumptions used in determining the net periodic benefit costs for the benefit plans, which uses the end of the prior year as the measurement date:

	Pension Benefits		Other Benefits	
	2013	2012	2013	2012
Weighted average assumptions as of December 31:				
Discount rate	4.10%	4.40%	4.20%	4.50%
Long-term rate of return on plan assets	7.00%	7.00%	6.00%	6.25%
Rate of compensation increases	3.50%	3.50%		

The health care cost trend rate assumption has a significant effect on the amounts reported. For 2013 measurement purposes, the Company assumed an 9.2% annual rate of increase in the per capita cost of covered benefits with the rate decreasing to 6.1% by 2018, then gradually grading down to 5.0% over the next 50 years. A one-percentage point change in assumed health care cost trends is estimated to have the following effect:

	1-Percentage Point Increase	1-Percentage Point (Decrease)
Effect on total service and interest costs	$ 2,656	$ (1,936)
Effect on accumulated postretirement benefit obligation	$ 18,085	$ (13,805)

The Company intends to make annual contributions to the plans up to the amount deductible for tax purposes. The Company estimates in 2014 that the annual contribution to the pension plans will be $28,286 and the annual contribution to the other postretirement plan will be $9,568.

CALIFORNIA WATER SERVICE GROUP

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12 STOCK-BASED COMPENSATION PLANS

The Company has one stockholder-approved stock-based compensation plan.

Equity Incentive Plan

The Company's equity incentive plan was approved by stockholders on April 27, 2005. The Company is authorized to issue awards up to 2,000,000 shares of common stock.

During 2013 and 2012, the Company granted annual Restricted Stock Awards (RSAs) of 74,824 and 101,236 shares, respectively, of common stock to officers and directors of the Company. In 2013 no RSAs were cancelled and 10,050 RSAs were cancelled in 2012. Employee RSAs granted have a one-year cliff vesting. RSAs granted in 2013 vest over 36 months and RSAs granted in 2012 vest over 48 months. Director RSAs generally vest at the end of 12 months. During 2013 and 2012, the shares granted were valued at $20.66 and $17.96 per share, respectively, based upon the fair market value of the Company's common stock on the date of grant.

On March 1, 2013, the Company granted performance-based Restricted Stock Unit Awards (RSUs) of 50,267 shares of common stock to officers. Each award reflects a target number of shares that may be issued to the award recipient. The awards may be earned upon the completion of the three-year performance period ending February 28, 2016. Whether RSUs are earned at the end of the performance period will be determined based on the achievement of certain performance objectives set by the Board of Director Compensation Committee in connection with the issuance of the RSUs. The performance objectives are based on the Company's business plan covering the performance period. The performance objectives include achieving the budgeted return on equity, budgeted investment in utility plant, customer service standards, and water quality standards. Depending on the results achieved during the three-year performance period, the actual number of shares that a grant recipient receives at the end of the performance period may range from 0% to 200% of the target shares granted, provided that the grantee is continuously employed by the Company through the vesting date. If prior to the vesting date employment is terminated by reason of death, disability or normal retirement, then a pro rata portion of this award will vest. RSUs are not included in diluted shares for financial reporting until earned. The RSUs are recognized as expense ratably over the three year performance period using a fair market value of $20.62 per share and an estimate of RSUs earned during the performance period.

The Company has recorded compensation costs for the RSAs and RSUs which are included in administrative and general operating expenses in the amount of $1.8 million and $1.1 million for 2013 and 2012, respectively.

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Notes to Consolidated Financial Statements (Continued)

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13 FAIR VALUE OF FINANCIAL INSTRUMENTS

The accounting guidance for fair value measurements and disclosures provides a single definition of fair value and requires certain disclosures about assets and liabilities measured at fair value. A hierarchal framework for disclosing the observability of the inputs utilized in measuring assets and liabilities at fair value is established by this guidance. The three levels in the hierarchy are as follows:

Level 1 Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. The types of assets and liabilities included in Level 1 are highly liquid and actively traded instruments with quoted prices.
Level 2 Pricing inputs are other than quoted prices inactive markets, but are either directly or indirectly observable as of the reporting date. The types of assets and liabilities included in Level 2 are typically either comparable to actively traded securities or contracts, or priced with discounted cash flow or option pricing models using highly observable inputs.
Level 3 Significant inputs to pricing have little or no observability as of the reporting date. The types of assets and liabilities included in Level 3 are those valued with models requiring significant management judgment or estimation.

Specific valuation methods include the following:

Accounts receivable and accounts payable carrying amounts approximated the fair value because of the short-term maturity of the instruments.

Long-term debt fair values were estimated using the published quoted market price, if available, or the discounted cash flow analysis, based on the current rates available using a risk-free rate (a U.S. Treasury securities yield curve) plus a risk premium of 1.19%.

Advances for construction fair values were estimated using broker quotes from companies that frequently purchase these investments.

	December 31, 2013				
		Fair Value			
	Cost	Level 1	Level 2	Level 3	Total
Long-term debt, including current maturities	$ 434,050	$	$ 511,146	$	$ 511,146
Advances for construction	183,393		73,389		73,389
Total	$ 617,443	$	$ 584,535	$	$ 584,535

	December 31, 2012				
		Fair Value			
	Cost	Level 1	Level 2	Level 3	Total
Long-term debt, including current maturities	$ 481,250	$	$ 613,211	$	$ 613,211
Advances for construction	187,584		70,914		70,914
Total	$ 668,834	$	$ 684,125	$	$ 684,125

CALIFORNIA WATER SERVICE GROUP

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14 COMMITMENTS AND CONTINGENCIES

Commitments

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

	Facility Leases	System Lease	Water Contracts	Capital Lease Obligations
2014	$ 789	$ 845	$ 22,560	$ 1,109
2015	570	845	22,631	1,109
2016	333	845	22,702	1,109
2017	297	845	22,772	1,109
2018	248	493	22,774	1,016
Thereafter	3,318		503,646	7,593

Company Facility leases include office and other facilities in many of its operating districts. The total paid and charged to operations for such leases was $1,058 in 2013, $1,156 in 2012, and $1,271 in 2011. The system lease is a 15-year lease with the City of Commerce. The lease includes an annual lease payment of $845 per year plus a cost savings sharing arrangement.

The Company has a long-term contract with the Santa Clara Valley Water District that requires the Company to purchase minimum annual water quantities. Purchases are priced at the districts then-current wholesale water rate. The Company operates to purchase sufficient water to equal or exceed the minimum quantities under the contract. The total paid to Santa Clara Valley Water District was $7,407 in 2013, $6,164 in 2012, and $5,524 in 2011.

The Company also has a water supply contract with Stockton East Water District (SEWD) that requires a fixed, annual payment. Each year, the fixed annual payment is adjusted for changes to SEWD's costs. Because of the fixed annual price arrangement, the Company operates to receive as much water as possible from SEWD in order to minimize the cost of operating Company-owned wells used to supplement SEWD deliveries. The total paid under the contract was $9,990 in 2013, $6,591 in 2012, and $6,658 in 2011.

Estimated annual contractual obligations in the table above are based on the same payment levels as 2013. Future increased costs by SEWD are expected to be offset by a decline in the allocation of costs to the Company, as other customers of SEWD are expected to receive a larger allocation based upon growth of their service areas.

On September 21, 2005, the Company entered into an agreement with Kern County Water Agency (Agency) to obtain treated water for the Company's operations. The term of the agreement is to January 1, 2035, or until the repayment of the Agency's bonds (described hereafter) occurs. Under the terms of the agreement, the Company is obligated to purchase approximately 18,500 acre feet of treated water in 2013 and an incrementally higher volume of water for each subsequent year until 2017, when the Company is obligated to purchase 20,500 acre feet of treated water per year. The Company is obligated to pay the Capital Facilities Charge and the Treated Water Charge regardless of whether it can use the water in its operation, and is obligated for these charges even if the Agency cannot produce an adequate amount to

CALIFORNIA WATER SERVICE GROUP

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14 COMMITMENTS AND CONTINGENCIES (Continued)

supply the 20,500 acre feet in the year. (This agreement supersedes a prior agreement with Kern County Water Agency for the supply of 11,500 acre feet of water per year). Total annual expense in 2013 was $6,289, $6,272 in 2012, and $6,129 in 2011.

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

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

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

The total obligation of all parties, excluding the Company, is approximately $82,397 to the Agency. Based on the credit worthiness of the other participants, which are government entities, it is believed to be highly unlikely that the Company would be required to assume any other parties' obligations under the contract due to their default. In the event of default by a party, the Company would receive entitlement to the additional water for assuming any obligation.

We pay a capital facilities charge and charges related to treated water that together total $7,224 annually, which equates to $352 dollars per acre foot. Total treated water charge for 2013 was $2,599. As treated water is being delivered, we will also be obligated for our portion of the operating costs; that portion is currently estimated to be $7 dollars per acre foot. The actual amount will vary due to variations from estimates, inflation, and other changes in the cost structure. Our overall estimated cost of $352 dollars per acre foot is less than the estimated cost of procuring untreated water (assuming water rights could be obtained) and then providing treatment.

There are three capital leases, the most significant was the City of Hawthorne water system. In 2011, we entered into a 15-year capital lease agreement to operate the City of Hawthorne water system. The system, which is located near the Hermosa Redondo district, serves about half of Hawthorne's population. The agreement required us to make an up-front $8,100 lease deposit to the city that is being amortized

CALIFORNIA WATER SERVICE GROUP

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14 COMMITMENTS AND CONTINGENCIES (Continued)

over the lease term. Additionally, annual lease payments of $940 are made to the city and shall be increased or decreased each year on July 1, by the same percentage that the rates charged to customers served by the water system increased or decreased, exclusive of pass-through increases or decreases in the cost of water, power, and city-imposed fees, compared to the rates in effect on July 1 of the prior year, provided, that in no event will the annual lease payment be less than $940. Under the lease we are responsible for all aspects of system operation and capital improvements, although title to the system and system improvements reside with the city. In exchange, we receive all revenue from the water system, which was $7,688, $7,621, and $7,506 in 2013, 2012, and 2011, respectively. At the end of the lease, the city is required to reimburse us for the unamortized value of capital improvements made during the term of the lease. The annual payments were $940 in 2013, $940 in 2012, and $537 in 2011.

Contingencies

Groundwater Contamination

The Company has undertaken litigation against third parties to recover past and future costs related to ground water contamination in our service areas. The cost of litigation is expensed as incurred and any settlement is first offset against such costs. The Commission's general policy requires all proceeds from contamination litigation to be used first to pay transactional expenses, then to make ratepayers whole for water treatment costs to comply with the Commission's water quality standards. The Commission allows for a risk-based consideration of contamination proceeds which exceed the costs of the remediation described above and may result in some sharing of proceeds with the shareholder, determined on a case by case basis. The Commission has authorized various memorandum accounts that allow the Company to track significant litigation costs to request recovery of these costs in future filings and uses of proceeds to comply with Commission's general policy.

Other Legal Matters

From time to time, the Company is involved in various disputes and litigation matters that arise in the ordinary course of business. The status of each significant matter is reviewed and assessed for potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount of the range of loss can be estimated, a liability is accrued for the estimated loss in accordance with the accounting standards for contingencies. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, accruals are based on the best information available at the time. While the outcome of these disputes and litigation matters cannot be predicted with any certainty, management does not believe when taking into account existing reserves the ultimate resolution of these matters will materially affect the Company's financial position, results of operations, or cash flows. The Company has recognized a liability of $1.3 million for all known legal matters as of December 31, 2013 and December 31, 2012. The cost of litigation is expensed as incurred and any settlement is first offset against such costs. Any settlement in excess of the cost to litigate is accounted for on a case by case basis, dependant on the nature of the settlement.

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15 QUARTERLY FINANCIAL DATA (UNAUDITED)

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

2013	**First**	**Second**	**Third**	**Fourth**
Operating revenue	$ 111,444	$ 154,555	$ 184,404	$ 133,700
Net operating income	5,770	20,783	35,804	11,648
Net income (loss)	(1,073)	13,510	29,151	5,666
Diluted earnings (loss) per share	(0.03)	0.28	0.61	0.12
Common stock market price range:				
High	21.22	20.84	22.34	23.43
Low	18.42	18.54	18.87	19.65
Dividends paid per common share	0.1600	0.1600	0.1600	0.1600

2012	**First**	**Second**	**Third**	**Fourth**
Operating revenue	$ 116,749	$ 143,552	$ 178,135	$ 121,530
Net operating income	6,607	19,622	36,361	11,253
Net income	1,085	12,965	29,772	5,006
Diluted earnings per share	0.03	0.31	0.71	0.12
Common stock market price range:				
High	19.25	18.60	19.05	18.90
Low	17.67	17.14	17.93	16.84
Dividends paid per common share	0.1575	0.1575	0.1575	0.1575

16 CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

On April 17, 2009, Cal Water issued $100 million aggregate principal amount of 5.875% First Mortgage Bonds due 2019, and on November 17, 2010, Cal Water issued $100 million aggregate principal amount of 5.500% First Mortgage Bonds due 2040, all of which are fully and unconditionally guaranteed by California Water Service Group (Parent Company). As a result of these guarantee arrangements, we are required to present the following condensed consolidating financial information.

The following tables present the condensed consolidating balance sheets as of December 31, 2013 and 2012, the condensed consolidating statements of income for the years ended December 31, 2013, 2012 and 2011, and the condensed consolidating statements of cash flows for the years ended December 31, 2013, 2012, and 2011, of (i) California Water Service Group the guarantor of the first mortgage bonds and the parent company; (ii)California Water Service Company, the issuer of the first mortgage bonds and a 100% owned subsidiary of California Water Service Group; and (iii) the other 100% owned subsidiaries of California Water Service Group.

CALIFORNIA WATER SERVICE GROUP

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16 CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING BALANCE SHEET
As of December 31, 2013

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
			(In thousands)		
ASSETS					
Utility plant:					
Utility plant	$ 1,318	$ 2,034,935	$ 184,272	$ (7,197)	$ 2,213,328
Less accumulated depreciation and amortization	(164)	(661,780)	(37,168)	1,615	(697,497)
Net utility plant	1,154	1,373,155	147,104	(5,582)	1,515,831
Current assets:					
Cash and cash equivalents	5,280	20,790	1,436		27,506
Receivables	(756)	90,008	8,931	(94)	98,089
Receivables from affiliates	16,747	5,755		(22,502)	
Other current assets		13,011	884		13,895
Total current assets	21,271	129,564	11,251	(22,596)	139,490
Other assets:					
Regulatory assets		248,938	2,743		251,681
Investments in affiliates	565,347			(565,347)	
Long-term affiliate notes receivable	26,255			(26,255)	
Other assets	1,120	44,827	7,111	(205)	52,853
Total other assets	592,722	293,765	9,854	(591,807)	304,534
	$ 615,147	$ 1,796,484	$ 168,209	$ (619,985)	$ 1,959,855
CAPITALIZATION AND LIABILITIES					
Capitalization:					
Common stockholders' equity	$ 598,756	$ 500,290	$ 70,548	$ (570,838)	$ 598,756
Affiliate long-term debt			26,255	(26,255)	

Long-term debt, less current maturities		424,854	1,288		426,142
Total capitalization	598,756	925,144	98,091	(597,093)	1,024,898
Current liabilities:					
Current maturities of long-term debt		6,137	1,771		7,908
Short-term borrowings	16,815	30,000			46,815
Payables to affiliates	48		22,454	(22,502)	
Accounts payable		51,764	3,323		55,087
Accrued expenses and other liabilities	107	55,346	1,321		56,774
Total current liabilities	16,970	143,247	28,869	(22,502)	166,584
Unamortized investment tax credits		2,106			2,106
Deferred income taxes, net	(579)	179,870	4,344	(390)	183,245
Pension and postretirement benefits other than pensions		145,451			145,451
Regulatory and other liabilities		77,627	8,828		86,455
Advances for construction		182,776	617		183,393
Contributions in aid of construction		140,263	27,460		167,723
	$ 615,147	$ 1,796,484	$ 168,209	$ (619,985)	$ 1,959,855

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16 CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING BALANCE SHEET
As of December 31, 2012

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
			(In thousands)		
ASSETS					
Utility plant:					
Utility plant	$ 606	$ 1,927,190	$ 175,764	$ (7,197)	$ 2,096,363
Less accumulated depreciation and amortization	(108)	(607,992)	(32,710)	1,503	(639,307)
Net utility plant	498	1,319,198	143,054	(5,694)	1,457,056
Current assets:					
Cash and cash equivalents	1,470	34,609	2,711		38,790
Receivables		87,482	3,833		91,315
Receivables from affiliates	19,367	3,195	1,152	(23,714)	
Other current assets		15,535	924		16,459
Total current assets	20,837	140,821	8,620	(23,714)	146,564
Other assets:					
Regulatory assets		341,877	2,542		344,419
Investments in affiliates	492,188			(492,188)	
Long-term affiliate notes receivable	31,218	7,781		(38,999)	
Other assets	1,023	40,005	7,062	(205)	47,885
Total other assets	524,429	389,663	9,604	(531,392)	392,304
	$ 545,764	$ 1,849,682	$ 161,278	$ (560,800)	$ 1,995,924
CAPITALIZATION AND LIABILITIES					
Capitalization:					
Common stockholders' equity	$ 473,712	$ 442,923	$ 54,774	$ (497,697)	$ 473,712
Affiliate long-term debt	7,781		31,218	(38,999)	

Long-term debt, less current maturities		431,433	3,034		434,467
Total capitalization	481,493	874,356	89,026	(536,696)	908,179
Current liabilities:					
Current maturities of long-term debt		46,104	679		46,783
Short-term borrowings	64,475	25,000			89,475
Payables to affiliates	77	1,152	22,485	(23,714)	
Accounts payable		41,352	5,847		47,199
Accrued expenses and other liabilities	298	58,293	1,019		59,610
Total current liabilities	64,850	171,901	30,030	(23,714)	243,067
Unamortized investment tax credits		2,180			2,180
Deferred income taxes, net	(579)	155,481	4,334	(390)	158,846
Pension and postretirement benefits other than pensions		244,901			244,901
Regulatory and other liabilities		83,942	8,651		92,593
Advances for construction		186,753	831		187,584
Contributions in aid of construction		130,168	28,406		158,574
	$ 545,764	$ 1,849,682	$ 161,278	$ (560,800)	$ 1,995,924

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16 CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING STATEMENT OF INCOME
For the Year Ended December 31, 2013

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
			(In thousands)		
Operating revenue	$	$ 552,327	$ 31,776	$	$ 584,103
Operating expenses:					
Operations:					
Purchased water		182,503	543		183,046
Purchased power		22,932	9,288		32,220
Pump taxes		10,795			10,795
Administrative and general	69	87,620	10,366		98,055
Other		63,237	7,005	(504)	69,738
Maintenance		16,654	714		17,368
Depreciation and amortization	56	54,886	3,490	(112)	58,320
Income tax (benefit) expense	(304)	19,890	(1,880)	1,341	19,047
Taxes other than income taxes		18,679	2,830		21,509
Total operating (income) expenses	(179)	477,196	32,356	725	510,098
Net operating income (loss)	179	75,131	(580)	(725)	74,005
Other Income and Expenses:					
Non-regulated revenue	2,323	13,606	1,918	(3,052)	14,795
Non-regulated expense	(337)	(9,465)	(1,463)		(11,265)
Income tax (expense) on other income and expense	(809)	(1,687)	(222)	1,296	(1,422)
Net other income	1,177	2,454	233	(1,756)	2,108
Interest:					
Interest expense	621	30,238	2,585	(2,547)	30,897
Less: capitalized interest		(1,662)	(376)		(2,038)
Net interest expense	621	28,576	2,209	(2,547)	28,859

Equity earnings of subsidiaries	46,519			(46,519)	
Net income (loss)	$ 47,254	$ 49,009	$ (2,556)	$ (46,453)	$ 47,254

CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

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16 CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING STATEMENT OF INCOME
For the Year Ended December 31, 2012

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
			(In thousands)		
Operating revenue	$	$ 527,449	$ 32,517	$	$ 559,966
Operating expenses:					
Operations:					
Purchased water		160,913	423		161,336
Purchased power		21,435	9,592		31,027
Pump taxes		10,336			10,336
Administrative and general		84,399	9,528		93,927
Other		70,864	6,744	(504)	77,104
Maintenance		18,478	664		19,142
Depreciation and amortization		52,012	2,774	(118)	54,668
Income tax (benefit) expense	(583)	18,992	(375)	1,322	19,356
Taxes other than income taxes		16,630	2,597		19,227
Total operating (income) expenses	(583)	454,059	31,947	700	486,123
Net operating income	583	73,390	570	(700)	73,843
Other Income and Expenses:					
Non-regulated revenue	1,919	15,204	2,420	(2,857)	16,686
Non-regulated expense		(9,588)	(1,965)		(11,553)
Gain on sale on non-utility property		81		3	84
Income tax (expense) on other income and expense	(782)	(2,321)	(266)	1,273	(2,096)
Net other income	1,137	3,376	189	(1,581)	3,121
Interest:					
Interest expense	1,430	30,328	2,132	(2,353)	31,537
Less: capitalized interest		(2,334)	(1,067)		(3,401)
Net interest expense	1,430	27,994	1,065	(2,353)	28,136

Equity earnings of subsidiaries	48,538			(48,538)	
Net income (loss)	$ 48,828	$ 48,772	$ (306)	$ (48,466)	$ 48,828

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CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

December 31, 2013, 2012, and 2011

Amounts in thousands, except share data

16 CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

CALIFORNIA WATER SERVICE GROUP
CONDENSED CONSOLIDATING STATEMENT OF INCOME
For the Year Ended December 31, 2011

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
			(In thousands)		
Operating revenue	$	$ 472,150	$ 29,664	$	$ 501,814
Operating expenses:					
Operations:					
Purchased water		142,355	215		142,570
Purchased power		20,719	9,334		30,053
Pump taxes		8,764	366		9,130
Administrative and general		77,622	8,136		85,758
Other		47,800	7,401	(505)	54,696
Maintenance		19,916	782		20,698
Depreciation and amortization		47,872	2,637	(124)	50,385
Income tax (benefit) expense	(580)	23,727	(1,727)	1,605	23,025
Taxes other than income taxes		15,908	2,424		18,332
Total operating (income) expenses	(580)	404,683	29,568	976	434,647
Net operating income	580	67,467	96	(976)	67,167
Other Income and Expenses:					
Non-regulated revenue	2,248	12,972	4,322	(3,382)	16,160
Non-regulated expense		(12,287)	(3,535)		(15,822)
Gain on sale on non-utility property		62			62
Income tax (expense) on other income and expense	(916)	(304)	(422)	1,501	(141)
Net other income	1,332	443	365	(1,881)	259
Interest:					
Interest expense	1,422	31,421	2,489	(2,877)	32,455
Less: capitalized interest		(1,844)	(897)		(2,741)
Net interest expense	1,422	29,577	1,592	(2,877)	29,714

Equity earnings of subsidiaries		37,222						(37,222)		
Net income (loss)	$	37,712	$	38,333	$	(1,131)	$	(37,202)	$	37,712

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CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

December 31, 2013, 2012, and 2011

Amounts in thousands, except share data

16 CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

CALIFORNIA WATER SERVICE GROUP
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2013

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
			(In thousands)		
Operating activities:					
Net income (loss)	$ 47,254	$ 49,009	$ (2,556)	$ (46,453)	$ 47,254
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity earnings of subsidiaries	(46,519)			46,519	
Dividends received from affiliates	29,619			(29,619)	
Depreciation and amortization	56	56,670	3,636	(112)	60,250
Change in value of life insurance contracts		(1,878)			(1,878)
Stock-based compensation	1,832				1,832
Changes in deferred income taxes		9,800			9,800
Other changes in noncurrent assets and liabilities	(76)	11,899	(449)	(49)	11,325
Changes in operating assets and liabilities	544	226	(5,275)	95	(4,410)
Net cash provided by (used in) operating activities	32,710	125,726	(4,644)	(29,619)	124,173
Investing activities:					
Utility plant expenditures	(712)	(111,819)	(10,457)		(122,988)
Investment in affiliates	(35,000)			35,000	
Affiliate advances	(14,903)	(2,575)	1,210	16,268	
Proceeds from affiliate loans	1,227	7,796		(9,023)	
Purchase of life insurance		(3,281)			(3,281)
Restricted cash decrease		1,073			1,073
Net cash (used in) investing activities	(49,388)	(108,806)	(9,247)	42,245	(125,196)
Financing Activities:					
Short-term borrowings	20,615	50,000			70,615
Repayment of short-term borrowings	(68,275)	(45,000)			(113,275)
Affiliate advances	(14)	(1,152)	17,434	(16,268)	
Reduction of affiliate long-term borrowings	(7,796)		(1,227)	9,023	
Proceeds from long-term debt			48		48
Repayment of long-term debt		(46,547)	(701)		(47,248)
Advances and contributions in aid for construction		10,465	98		10,563
Refunds of advances for construction		(6,814)	(108)		(6,922)
Dividends paid to non-affiliates	(29,619)				(29,619)
Dividends paid to affiliates		(26,691)	(2,928)	29,619	

Issuance of common stock	105,577				105,577
Investment from affiliates		35,000		(35,000)	
Net cash provided by (used in) financing activities	20,488	(30,739)	12,616	(12,626)	(10,261)
Change in cash and cash equivalents	3,810	(13,819)	(1,275)		(11,284)
Cash and cash equivalents at beginning of year	1,470	34,609	2,711		38,790
Cash and cash equivalents at end of year	$ 5,280	$ 20,790	$ 1,436	$	$ 27,506

CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

December 31, 2013, 2012, and 2011

Amounts in thousands, except share data

16 CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2012

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
			(In thousands)		
Operating activities:					
Net income (loss)	$ 48,828	$ 48,772	$ (306)	$ (48,466)	$ 48,828
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity earnings of subsidiaries	(48,538)			48,538	
Dividends received from affiliates	26,387			(26,387)	
Depreciation and amortization	56	54,040	2,888	(118)	56,866
Change in value of life insurance contracts		(2,504)			(2,504)
Stock-based compensation	1,442				1,442
Gain on sale of non-utility property		(81)		(3)	(84)
Changes in deferred income taxes		34,133			34,133
Other changes in noncurrent assets and liabilities	102	(10,367)	1,307	133	(8,825)
Changes in operating assets and liabilities	(170)	9,035	(6,723)	(84)	2,058
Net cash provided by (used in) operating activities	28,107	133,028	(2,834)	(26,387)	131,914
Investing activities:					
Utility plant expenditures	(281)	(111,636)	(15,761)	(3)	(127,681)
Proceeds from sale of non-utility assets		82		3	85
Affiliate advances	(12,245)	254	(853)	12,844	
Proceeds from affiliate loans	552	48		(600)	
Reduction of loans to affiliates	(5,675)			5,675	
Purchase of life insurance		(3,294)			(3,294)
Restricted cash decrease		1,959			1,959
Net cash (used in) investing activities	(17,649)	(112,587)	(16,614)	17,919	(128,931)
Financing Activities:					
Short-term borrowings	18,335	76,000			94,335
Repayment of short-term borrowings	(1,000)	(51,000)			(52,000)
Affiliate advances	23	962	11,859	(12,844)	
Proceeds from affiliates long-term borrowings			5,675	(5,675)	
Reduction of affiliate long-term borrowings	(48)		(552)	600	
Proceeds from long-term debt			124		124

Retirement of long-term debt		(6,310)	(727)		(7,037)
Advances and contributions in aid for construction		6,883	83		6,966
Refunds of advances for construction		(7,275)	(122)		(7,397)
Dividends paid to non-affiliates	(26,387)				(26,387)
Dividends paid to affiliates		(23,567)	(2,820)	26,387	
Net cash (used in) provided by financing activities	(9,077)	(4,307)	13,520	8,468	8,604
Change in cash and cash equivalents	1,381	16,134	(5,928)		11,587
Cash and cash equivalents at beginning of year	89	18,475	8,639		27,203
Cash and cash equivalents at end of year	$ 1,470	$ 34,609	$ 2,711	$	$ 38,790

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CALIFORNIA WATER SERVICE GROUP

Notes to Consolidated Financial Statements (Continued)

December 31, 2013, 2012, and 2011

Amounts in thousands, except share data

16 CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2011

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
			(In thousands)		
Operating activities:					
Net income (loss)	$ 37,712	$ 38,333	$ (1,131)	$ (37,202)	$ 37,712
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity earnings of subsidiaries	(37,222)			37,222	
Dividends received from affiliates	25,674			(25,674)	
Depreciation and amortization	51	49,283	2,771	(124)	51,981
Change in value of life insurance contracts		1,876			1,876
Stock-based compensation	1,300				1,300
Gain on sale of non-utility property		(62)			(62)
Change in deferred income taxes		2,723			2,723
Other changes in noncurrent assets and liabilities	(299)	(45)	684	53	393
Changes in operating assets and liabilities	582	11,662	3,054	51	15,349
Net cash provided by operating activities	27,798	103,770	5,378	(25,674)	111,272
Investing activities:					
Utility plant expenditures		(98,410)	(20,136)		(118,546)
Proceeds from sale of non-utility assets		64			64
Affiliate advances	(25,495)	1,597		23,898	
Reduction of loans to affiliates	962	45	2,000	(3,007)	
Purchase of life insurance		(1,744)			(1,744)
Restricted cash increase		(3,042)			(3,042)
Net cash (used in) investing activities	(24,533)	(101,490)	(18,136)	20,891	(123,268)
Financing Activities:					
Short-term borrowings	23,390				23,390
Affiliate advances			23,898	(23,898)	
Reduction of affiliate long-term borrowings	(2,045)		(962)	3,007	
Proceeds from long-term debt, net of issuance cost of $1,857			178		178
Retirement of long-term debt		(2,279)	(684)		(2,963)
Advances and contributions in aid for construction		7,082	149		7,231
Refunds of advances for construction		(6,129)	(76)		(6,205)

Dividends paid to non-affiliates	(25,674)				(25,674)
Dividends paid to affiliates		(22,925)	(2,749)	25,674	
Issuance of common stock	965				965
Net cash (used in) provided by financing activities	(3,364)	(24,251)	19,754	4,783	(3,078)
Change in cash and cash equivalents	(99)	(21,971)	6,996		(15,074)
Cash and cash equivalents at beginning of year	188	40,446	1,643		42,277
Cash and cash equivalents at end of year	$ 89	$ 18,475	$ 8,639	$	$ 27,203

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.***

None

Item 9A. ***Controls and Procedures***

Management's Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure.

In designing and evaluating the disclosure controls and procedures, management, including the Chief Executive Officer and Chief Financial Officer, recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Accordingly, our disclosure controls and procedures have been designed to provide reasonable assurance of achieving their objectives.

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2013. Based on that evaluation, we concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

There was no change in our internal control over financial reporting during the quarter ended December 31, 2013, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended). Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2013. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in "Internal Control Integrated Framework." Management has concluded that, as of December 31, 2013, our internal control over financial reporting is effective based on these criteria. Our independent registered public accounting firm, Deloitte & Touche LLP, has audited the effectiveness of our internal control over financial reporting as of December 31, 2013, as stated in their report, which is included herein.

Item 9B. ***Other Information***

On February 26, 2014, the Board of Directors of California Water Service Group appointed Terry P. Bayer a director of the Company, effective March 1, 2014, to serve until the next election of Directors by the stockholders. The appointment of Ms. Bayer expands the number of Directors from 9 to 10.

Terry P. Bayer, 63, is the Chief Operating Officer for Molina Healthcare, Inc., a managed care company that provides Medicaid and Medicare related solutions to meet the health care needs of low-income individuals and families. In this role, Ms. Bayer is responsible for operational oversight of the company's health plans in 11 states, as well as provider payment and information systems. Terry has more than 30 years of health care management experience, including staff model clinic administration, provider contracting, managed care operations, disease management and home care.

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Ms. Bayer previously served on the Board of Directors of Apria Healthcare Group, Inc. from 2006 to 2008 where she served as chair of the compliance committee and served as a member of the compensation committee.

Ms. Bayer holds a Juris Doctor degree from Stanford University, a Master's degree in Public Health from the University of California, Berkeley, and a Bachelor's Degree in Communications from Northwest University.

Ms. Bayer brings to the Board her many years of experience as an operating executive of Molina Healthcare, with a strong focus on government program compliance and administration as well as customer service. Her previous experience as a director of Apria Healthcare Group and committee member will allow her to contribute to the Company in the future.

There are no arrangements or understandings between Ms. Bayer and any other persons pursuant to which Ms. Bayer was appointed a Director of the Company. There is no information that is required to be disclosed with respect to Ms. Bayer pursuant to Item 404(a) of Regulation S-K.

Ms. Bayer's compensation will be prorated for 10 months of service and be on the same basis as other nonemployee directors: a prorated annual cash retainer in the amount of $37,500, and prorated annual equity compensation, to be paid in restricted stock, in the amount of $45,834.

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PART III

Item 10. *Directors and Executive Officers and Corporate Governance*

The information required by this Item as to directors of the Company and the Company's Audit Committee is contained in the sections captioned "Board Structure" and "Proposal No. 1 Election of Directors" of the 2014 Proxy Statement, and is incorporated herein by reference.

Information required by this Item regarding executive officers is included in a separate section captioned "Executive Officers of the Registrant" contained in Part I of this annual report.

Information required by this Item as to our Code of Ethics is contained in the section captioned "Other Matters Code of Ethics" of the 2014 Proxy Statement, and is incorporated herein by reference.

We have adopted a code of ethics that applies to all of our directors, officers, and employees, including our principal executive, financial and accounting officers, or persons performing similar functions. Our Code of Ethics is posted on our corporate governance website located at http://www.calwatergroup.com. In addition, amendments to the Code of Ethics and any grant of a waiver from a provision of the Code of Ethics requiring disclosure under applicable SEC and NYSE rules will be disclosed at the same location as the Code of Ethics on our corporate governance website located at http://www.calwatergroup.com.

Information required to be disclosed by this Item as to compliance with Section 16(a) filing requirements is contained in the section captioned "Stock Ownership of Management and Certain Beneficial Owners" of the 2014 Proxy Statement, and is incorporated herein by reference.

Item 11. *Executive Compensation*

The information required by this Item is contained under the captions "Compensation Discussion and Analysis," "Report of the Organization and Compensation Committee of the Board of Directors on Executive Compensation," and "Organization and Compensation Committee Interlocks and Insider Participation" of the 2014 Proxy Statement and is incorporated herein by reference.

Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*

The information required by this Item regarding security ownership of certain beneficial owners and management is contained in the section captioned "Stock Ownership of Management and Certain Beneficial Owners" of the 2014 Proxy Statement and is incorporated herein by reference.

The following table represents securities authorized to be issued under our equity compensation plan:

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Rights (a)	Weighted-Average Exercise Price of Outstanding Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plan (Excluding Securities Reflected in Column) (a)
Equity compensation plans approved by security holders	283,856	$ 19.13	942,977
Equity compensation plans not approved by security holders	-0-	-0-	-0-
Total	283,856	$ 19.13	942,977

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Item 13. ***Certain Relationships and Related Transactions and Director Independence***

The information required by this Item is contained in the sections captioned "Certain Related Persons Transactions" and "Board Structure" of the 2014 Proxy Statement and is incorporated herein by reference.

Item 14. ***Principal Accountant Fees and Services***

The information required by this Item is contained in the section captioned "Report of the Audit Committee" and "Relationship with the Independent Registered Public Accounting Firm" of the 2014 Proxy Statement and is incorporated herein by reference.

PART IV

Item 15. ***Exhibits, Financial Statement Schedules***

(a)

As part of this Form 10-K, the following documents are being filed:

1. *Financial Statement:* See "Index to Consolidated Financial Statements" in Part II, Item 8 of this Form 10-K.

2. *Financial Statement Schedules:* No financial statement schedules are being included since the information otherwise required is included in the financial statements and the notes thereto.

3. *Exhibits:* The exhibits listed in the accompanying index to exhibits are filed or incorporated by reference.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized

CALIFORNIA WATER SERVICE GROUP

By /s/ MARTIN A. KROPELNICKI

MARTIN A. KROPELNICKI,
President and Chief Executive Officer

Date: February 27, 2014

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ PETER C. NELSON PETER C. NELSON	Chairman, Board of Directors	Date: February 27, 2014
/s/ EDWIN A. GUILES EDWIN A. GUILES	Member, Board of Directors	Date: February 27, 2014
/s/ BONNIE G. HILL BONNIE G. HILL	Member, Board of Directors	Date: February 27, 2014
/s/ THOMAS M. KRUMMEL THOMAS M. KRUMMEL, M.D.	Member, Board of Directors	Date: February 27, 2014
/s/ RICHARD P. MAGNUSON RICHARD P. MAGNUSON	Member, Board of Directors	Date: February 27, 2014
/s/ LINDA R. MEIER LINDA R. MEIER	Member, Board of Directors	Date: February 27, 2014
/s/ LESTER A. SNOW LESTER A. SNOW	Member, Board of Directors	Date: February 27, 2014
/s/ GEORGE A. VERA GEORGE A. VERA	Member, Board of Directors	Date: February 27, 2014

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/s/ MARTIN A. KROPELNICKI MARTIN A. KROPELNICKI	President and Chief Executive Officer; Principal Executive Officer; Member, Board of Directors	Date: February 27, 2014
/s/ THOMAS F. SMEGAL III THOMAS F. SMEGAL III	Chief Financial Officer and Treasurer; Principal Financial Officer	Date: February 27, 2014
/s/ DAVID B. HEALEY DAVID B. HEALEY	Corporate Controller and Assistant Treasurer; Principal Accounting Officer	Date: February 27, 2014

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EXHIBIT INDEX

Unless filed with this Form 10-K, the documents listed are incorporated by reference to the filings referred to:

Exhibit Number	
3.1	Certificate of Incorporation of California Water Service Group (Exhibit 3.1 to the Quarterly Report on Form 10-Q filed August 9, 2006)
3.2	Certificate of Amendment to Certificate of Incorporation of California Water Service Group (Exhibit 3.1 to the Current Report on Form 8-K filed June 10, 2011)
3.3	Restated Bylaws of California Water Service Group as amended on October 26, 2011 (Exhibit 3.2 to Current Report on Form 8-K filed October 26, 2011)
4.1	[reserved]
4.2	Certificate of Designations regarding Series D Participating Preferred Stock, as filed with Delaware Secretary of State on September 16, 1999 (Exhibit 4.2 to Annual Report on Form 10-K for the year ended December 31, 2003)
4.3	Thirty-Ninth Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee (Exhibit 4.1 to Current Report on Form 8-K filed April 21, 2009)
4.4	Fortieth Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 9.86% First Mortgage Bonds due 2020, Series CC. (Exhibit 4.2 to Current Report on Form 8-K filed April 21, 2009)
4.5	Forty-First Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 5.875% First Mortgage Bonds due 2019, Series LL. (Exhibit 4.3 to Current Report on Form 8-K filed April 21, 2009)
4.6	Forty-Second Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 6.94% First Mortgage Bonds due 2012, Series KK. (Exhibit 4.4 to Current Report on Form 8-K filed April 21, 2009)
4.7	Forty-Third Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 7.28% First Mortgage Bonds due 2025, Series AAA. (Exhibit 4.5 to Current Report on Form 8-K filed April 21, 2009)
4.8	Forty-Fourth Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 6.77% First Mortgage Bonds due 2028, Series BBB. (Exhibit 4.6 to Current Report on Form 8-K filed April 21, 2009)
4.9	Forty-Fifth Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 8.15% First Mortgage Bonds due 2030, Series CCC. (Exhibit 4.7 to Current Report on Form 8-K filed April 21, 2009)

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Exhibit Number	
4.10	Forty-Sixth Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 7.13% First Mortgage Bonds due 2031, Series DDD. (Exhibit 4.8 to Current Report on Form 8-K filed April 21, 2009)
4.11	Forty-Seventh Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 7.11% First Mortgage Bonds due 2032, Series EEE. (Exhibit 4.9 to Current Report on Form 8-K filed April 21, 2009)
4.12	Forty-Eighth Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 5.90% First Mortgage Bonds due 2017, Series FFF. (Exhibit 4.10 to Current Report on Form 8-K filed April 21, 2009)
4.13	Forty-Ninth Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 5.29% First Mortgage Bonds due 2022, Series GGG. (Exhibit 4.11 to Current Report on Form 8-K filed April 21, 2009)
4.14	Fiftieth Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 5.29% First Mortgage Bonds due 2022, Series HHH. (Exhibit 4.12 to Current Report on Form 8-K filed April 21, 2009)
4.15	Fifty-First Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 5.54% First Mortgage Bonds due 2023, Series III. (Exhibit 4.13 to Current Report on Form 8-K filed April 21, 2009)
4.16	Fifty-Second Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 5.44% First Mortgage Bonds due 2018, Series JJJ. (Exhibit 4.14 to Current Report on Form 8-K filed April 21, 2009)
4.17	Fifty-Third Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 4.58% First Mortgage Bonds due 2010, Series KKK. (Exhibit 4.15 to Current Report on Form 8-K filed April 21, 2009)
4.18	Fifty-Fourth Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 5.48% First Mortgage Bonds due 2018, Series LLL. (Exhibit 4.16 to Current Report on Form 8-K filed April 21, 2009)
4.19	Fifty-Fifth Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 5.52% First Mortgage Bonds due 2013, Series MMM. (Exhibit 4.17 to Current Report on Form 8-K filed April 21, 2009)
4.20	Fifty-Sixth Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 5.55% First Mortgage Bonds due 2013, Series NNN. (Exhibit 4.18 to Current Report on Form 8-K filed April 21, 2009)

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Exhibit Number	
4.21	Fifty-Seventh Supplemental Indenture dated as of April 17, 2009, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 6.02% First Mortgage Bonds due 2031, Series OOO. (Exhibit 4.19 to Current Report on Form 8-K filed April 21, 2009)
4.22	Fifty-Eighth Supplemental Indenture dated as of November 22, 2010, between California Water Service Company and U.S. Bank National Association, as Trustee, covering 5.50% First Mortgage Bonds due 2040, Series PPP. (Exhibit 4.1 to Current Report on form 8-K filed November 22, 2010).
10.1	Water Supply Contract between Cal Water and County of Butte relating to Cal Water's Oroville District; Water Supply Contract between Cal Water and the Kern County Water Agency relating to Cal Water's Bakersfield District; Water Supply Contract between Cal Water and Stockton East Water District relating to Cal Water's Stockton District. (Exhibits 5(g), 5(h), 5(i), 5(j), Registration Statement No. 2-53678, which exhibits are incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 1974)
10.2	Water Supply Contract between the City and County of San Francisco and wholesale customers in Alameda County, San Mateo County and Santa Clara County for a term of twenty-five years beginning on July 1, 2009 and ending on June 30, 2034. The agreement was dated June 24, 2009. Water Supply Contract dated July 1, 2009 between the City and County of San Francisco and California Water Service Company to provide water to Bear Gulch and Bayshore service areas for a term of twenty-five years beginning July 1, 2009 and ending June 30, 2034. (Exhibit 10.3 and 10.4 to Quarterly Report on Form 10-Q for the quarter ending September 30, 2009).
10.3	Water Supply Contract dated January 27, 1981, between Cal Water and the Santa Clara Valley Water District relating to Cal Water's Los Altos District (Exhibit 10.3 to Annual Report on Form 10-K for the year ended December 31, 1992)
10.4	Amendments No. 3, 6 and 7 and Amendment dated June 17, 1980, to Water Supply Contract between Cal Water and the County of Butte relating to Cal Water's Oroville District. (Exhibit 10.5 to Annual Report on Form 10-K for the year ended December 31, 1992)
10.5	Amendment dated May 31, 1977, to Water Supply Contract between Cal Water and Stockton East Water District relating to Cal Water's Stockton District. (Exhibit 10.6 to Annual Report on Form 10-K for the year ended December 31, 1992)
10.6	Second Amended Contract dated September 25, 1987, among Stockton East Water District, California Water Service Company, the City of Stockton, the Lincoln Village Maintenance District, and the Colonial Heights Maintenance District Providing for the Sale of Treated Water. (Exhibit 10.7 to Annual Report on Form 10-K for the year ended December 31, 1987)
10.7	Water Supply Contract dated April 19, 1927, and Supplemental Agreement dated June 5, 1953, between Cal Water and Pacific Gas and Electric Company relating to Cal Water's Oroville District. (Exhibit 10.9 to Annual Report on Form 10-K for the year ended December 31, 1992)
10.8	[reserved]
10.9	[reserved]
10.10	Agreement between the City of Hawthorne and California Water Service Company for the 15-year lease of the City's water system. (Exhibit 10.17 to Quarterly Report on Form 10-Q for the quarter ended March 31, 1996)

Exhibit Number	
10.11	Water Supply Agreement dated September 25, 1996, between the City of Bakersfield and California Water Service Company. (Exhibit 10.18 to Quarterly Report on Form 10-Q for the quarter ended September 30, 1996)
10.12	Water Supply Contract dated November 16, 1994, between California Water Service Company and Alameda County Flood Control and Water Conservation District relating to Cal Water's Livermore District (Exhibit 10.15 to Annual Report on Form 10-K for the year ended December 31, 1994)
10.13	[reserved]
10.14	California Water Service Group Directors' Retirement Plan (As amended and restated on February 22, 2006) (Exhibit 10.14 to the Annual Report on Form 10-K for the year ended December 31, 2005)
10.15	[reserved]
10.16	Amended and Restated Credit Agreement dated as of June 29, 2011 among California Water Service Group and certain of its subsidiaries from time to time party thereto, as borrowers, Bank of America, N.A., as administrative agent, swing line lender and letter of credit issuer, Merrill Lynch, Pierce, Fenner & Smith Incorporated, as sole lead arranger and sole book manager, CoBank, ACB, as syndication agent, and Wells Fargo Bank, National Association, Bank of China, Los Angeles Branch, and U.S. Bank National Association, as co-documentation agents, and the other lender parties thereto.(Exhibit 10.1 to the Current Report on Form 8-K of the registrant dated July 1, 2011).
10.17	Amended and Restated Credit Agreement dated as of June 29, 2011 among California Water Service Company, as borrower, Bank of America, N.A., as administrative agent, swing line lender and letter of credit issuer, Merrill Lynch, Pierce, Fenner & Smith Incorporated, as sole lead arranger and sole book manager, CoBank, ACB, as syndication agent, Wells Fargo Bank, National Association, Bank of China, Los Angeles Branch, and U.S. Bank National Association, as co-documentation agents, and the other lender parties thereto (Exhibit 10.2 to the Current Report on Form 8-K of the registrant dated July 1, 2011).
10.18	Executive Severance Plan (Exhibit 10.24 to Annual Report on Form 10-K for the year ended December 31, 1998)*
10.19	California Water Service Group Long-Term Incentive Plan (filed as Appendix A of the California Water Service Group proxy statement dated March 17, 2000)*
10.20	California Water Service Group Deferred Compensation Plan effective January 1, 2001 (Exhibit 10.22 to Annual Report on Form 10-K for the year ended December 31, 2000)*
10.21	California Water Service Company Supplemental Executive Retirement Plan effective January 1, 2001 (Exhibit 10.23 to Annual Report on Form 10-K for the year ended December 31, 2000)*
10.22	Amendment No. 1 to California Water Service Company Supplemental Executive Retirement Plan effective January 1, 2001 (Exhibit 10.22 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2004)*
10.23	[reserved]
10.24	Water Supply Contract 99-73 between the City of Bakersfield and California Water Service Company, dated March 31, 1999 (Exhibit 10.25 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2003)

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Exhibit Number	
10.25	Amendment No. 1 to Water Supply Contract between the City of Bakersfield and California Water Service Company, dated October 3, 2001 (Exhibit 10.26 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2003)
10.26	[reserved]
10.27	Amendment No. 2 to California Water Service Company Supplemental Executive Retirement Plan effective January 1, 2001 (Exhibit 10.27 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2004)*
10.28	[reserved]
10.29	[reserved]
10.30	California Water Service Group Equity Incentive Plan (filed as Appendix B of the California Water Service Group proxy statement dated March 25, 2005, for its Annual Meeting of Stockholders to be held on April 27, 2005, as filed with the SEC on March 22, 2005 (File No. 1-13883))*
10.31	The registrant's policy on option repricing under its Equity Incentive Plan (incorporated by reference to Item 8.01 Other Events in the registrant's Current Report on Form 8-K dated April 7, 2005)*
10.32	Water Supply Contract dated September 21, 2005, between Cal Water and the Kern County Water Agency. (Exhibit 10.1 to Current Report on Form 8-K filed on September 21, 2005)
10.33	Separation Agreement between California Water Service Group and Richard D. Nye. (Exhibit 10 to Current Report on Form 8-K filed on December 22, 2005)*
10.34	Form of Stock Appreciation Right Grant Notice under the California Water Service Group Equity Incentive Plan. (Exhibit 10.34 to the Annual Report on Form 10-K for the year ended December 31, 2005)
10.35	Form of Stock Appreciation Right Agreement under the California Water Service Group Equity Incentive Plan with Notice of Exercise. (Exhibit 10.35 to the Annual Report on Form 10-K for the year ended December 31, 2005)
10.36	Form of Restricted Stock Award Grant Notice under the California Water Service Group Equity Incentive Plan. (Exhibit 10.36 to the Annual Report on Form 10-K for the year ended December 31, 2005)
10.37	[reserved]
10.38	Form of Restricted Stock Award Agreement under the California Water Service Group Equity Incentive Plan with Assignment Separate From Certificate and Joint Escrow Instructions. (Exhibit 10.38 to the Annual Report on Form 10-K for the year ended December 31, 2005)
10.39	Form of Stock Option Grant Notice for outside director under the California Water Service Group Equity Incentive Plan. (Exhibit 10.39 to the Annual Report on Form 10-K for the year ended December 31, 2005)
10.40	Form of Stock Option Grant Notice under the California Water Service Group Equity Incentive Plan. (Exhibit 10.40 to the Annual Report on Form 10-K for the year ended December 31, 2005)

Exhibit Number	
10.41	Form of Stock Option Agreement (Incentive Stock Option or Nonstatutory Stock Option) under the California Water Service Group Equity Incentive Plan with Notice of Exercise. (Exhibit 10.41 to the Annual Report on Form 10-K for the year ended December 31, 2005)
10.42	Offer Letter between the registrant and Martin A. Kropelnicki, dated February 15, 2006 (incorporated by reference to Exhibit 10.1 to Amendment No. 1 to Current Report on Form 8-K of the registrant, dated February 22, 2006)
10.43	Underwriting Agreement between California Water Service Group and Robert W. Baird & Co. Incorporated, as representative of the underwriters, October 5, 2006 (incorporated by reference to Exhibit 1.1 to Current Report on Form 8-K filed on October 6, 2006)
10.44	Form of Indemnification Agreement to be entered between California Water Service Group and its directors and officers. (Exhibit 10.44 to the Annual Report on Form 10-K for the year ended December 31, 2006)
12.1	Computation of Ratios of Earnings to Fixed Charges
21.	Subsidiaries of the Registrant
23.1	Consent of Independent Registered Public Accounting Firm
31.1	Chief Executive Officer certification of financial statements pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Chief Financial Officer certification of financial statements pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.	Chief Executive Officer and Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

* Management contract or compensatory plan or arrangement