

Global Water Resources, Inc.
Form 10-Q
May 10, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 001-37756

Global Water Resources, Inc.
(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

90-0632193
(I.R.S. Employer
Identification No.)

21410 N. 19th Avenue #220, Phoenix, AZ 85027
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (480) 360-7775

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during 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 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 No

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

Large accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)

Accelerated filer
Smaller reporting company
Emerging growth company

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes

No

As of May 7, 2018, the registrant had 19,631,266 shares of common stock, \$0.01 par value per share, outstanding.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

GLOBAL WATER RESOURCES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

(Unaudited)

| | March 31, 2018 | December 31, 2017 |
|---|-------------------|----------------------|
| ASSETS | | |
| PROPERTY, PLANT AND EQUIPMENT: | | |
| Property, plant and equipment | 287,160 | 289,051 |
| Less accumulated depreciation | (74,394) | (75,592) |
| Net property, plant and equipment | 212,766 | 213,459 |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | 6,915 | 5,248 |
| Accounts receivable — net | 1,354 | 1,528 |
| Due from affiliates | 463 | 430 |
| Accrued revenue | 1,799 | 1,759 |
| Prepaid expenses and other current assets | 684 | 700 |
| Total current assets | 11,215 | 9,665 |
| OTHER ASSETS: | | |
| Intangible assets — net | 12,772 | 12,772 |
| Regulatory asset | 1,871 | 1,871 |
| Bond service fund and other restricted cash | 499 | 436 |
| Equity method investment | 234 | 345 |
| Other noncurrent assets | 37 | 20 |
| Total other assets | 15,413 | 15,444 |
| TOTAL ASSETS | 239,394 | 238,568 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | 1,576 | 321 |
| Accrued expenses | 7,832 | 7,252 |
| Customer and meter deposits | 1,381 | 1,395 |
| Long-term debt and capital leases — current portion | 29 | 8 |
| Total current liabilities | 10,818 | 8,976 |
| NONCURRENT LIABILITIES: | | |
| Long-term debt and capital leases | 114,444 | 114,363 |
| Deferred regulatory gain - ICFA | 19,746 | 19,746 |
| Regulatory liability | 8,463 | 8,463 |
| Advances in aid of construction | 62,919 | 62,725 |
| Contributions in aid of construction — net | 4,376 | 4,425 |
| Deferred income tax liabilities, net | 3,228 | 3,114 |
| Acquisition liability | 934 | 934 |
| Other noncurrent liabilities | 579 | 962 |
| Total noncurrent liabilities | 214,689 | 214,732 |
| Total liabilities | 225,507 | 223,708 |
| Commitments and contingencies (see Note 13) | | |
| SHAREHOLDERS' EQUITY: | | |

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| | | |
|--|----------------|----------------|
| Common stock, \$0.01 par value, 60,000,000 shares authorized; 19,631,266 shares issued as of March 31, 2018 and December 31, 2017. | 196 | 196 |
| Paid in capital | 12,995 | 14,288 |
| Retained earnings | 696 | 376 |
| Total shareholders' equity | 13,887 | 14,860 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | 239,394 | 238,568 |

See accompanying notes to the condensed consolidated financial statements

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GLOBAL WATER RESOURCES, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (in thousands, except share and per share amounts)
 (Unaudited)

| | Three Months Ended March 31, | |
|--|---------------------------------|---------------|
| | 2018 | 2017 |
| REVENUES: | | |
| Water services | \$3,115 | \$ 2,785 |
| Wastewater and recycled water services | 4,297 | 3,988 |
| Unregulated revenues | 13 | 18 |
| Total revenues | 7,425 | 6,791 |
| OPERATING EXPENSES: | | |
| Operations and maintenance | 1,509 | 1,474 |
| Operations and maintenance - related party | 356 | 360 |
| General and administrative | 2,397 | 2,210 |
| Depreciation | 1,799 | 1,646 |
| Total operating expenses | 6,061 | 5,690 |
| OPERATING INCOME | 1,364 | 1,101 |
| OTHER INCOME (EXPENSE): | | |
| Interest income | 7 | 4 |
| Interest expense | (1,231) | (1,312) |
| Other | 323 | 352 |
| Other - related party | (2) | 214 |
| Total other income (expense) | (903) | (742) |
| INCOME BEFORE INCOME TAXES | 461 | 359 |
| INCOME TAX EXPENSE | (141) | (170) |
| NET INCOME | \$320 | \$ 189 |
| Basic earnings per common share | \$0.02 | \$ 0.01 |
| Diluted earnings per common share | \$0.02 | \$ 0.01 |
| Dividends declared per common share | \$0.07 | \$ 0.07 |
| Weighted average number of common shares used in the determination of: | | |
| Basic | 19,631,266 | 19,581,266 |
| Diluted | 19,669,991 | 19,622,751 |

See accompanying notes to the condensed consolidated financial statements

GLOBAL WATER RESOURCES, INC.

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(in thousands, except share and per share amounts)

(Unaudited)

| | Shares | Common Stock | Treasury Stock | Paid-in Capital | Retained Earnings | Total Equity |
|------------------------------------|------------|-----------------|-------------------|--------------------|----------------------|-----------------|
| BALANCE - December 31, 2017 | 19,631,266 | \$ 196 | \$ | —\$14,288 | \$ 376 | \$14,860 |
| Dividend declared \$0.07 per share | — | — | — | (1,391) | — | (1,391) |
| Stock compensation | — | — | — | 98 | — | 98 |
| Net income | — | — | — | — | 320 | 320 |
| BALANCE - March 31, 2018 | 19,631,266 | \$ 196 | \$ | —\$12,995 | \$ 696 | \$13,887 |

See accompanying notes to the condensed consolidated financial statements

GLOBAL WATER RESOURCES, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited, in thousands)

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------------|
| | 2018 | 2017 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$320 | \$189 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Deferred compensation | (9 |) 203 |
| Depreciation | 1,799 | 1,646 |
| Amortization of deferred debt issuance costs and discounts | 11 | 11 |
| Loss/(gain) on equity investment | 111 | (122) |
| Other (gains) and losses | (41 |) 4 |
| Provision for doubtful accounts receivable | 25 | 21 |
| Deferred income tax expense | 114 | 140 |
| Changes in assets and liabilities | | |
| Accounts receivable | 149 | 122 |
| Other current assets | (57 |) (100) |
| Accounts payable and other current liabilities | 1,506 | (12) |
| Other noncurrent assets | — | 27 |
| Other noncurrent liabilities | 59 | (30) |
| Net cash provided by operating activities | 3,987 | 2,099 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures | (1,101 |) (6,505) |
| Deposits of restricted cash, net | (62 |) (2) |
| Other cash flows from investing activities | 64 | (5) |
| Net cash used in investing activities | (1,099 |) (6,512) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Dividends paid | (1,391 |) (1,322) |
| Advances in aid of construction | 194 | 111 |
| Principal payments under capital lease | (1 |) (67) |
| Loan repayments | (6 |) — |
| Debt issuance costs paid | (17 |) — |
| Net cash used in financing activities | (1,221 |) (1,278) |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 1,667 | (5,691) |
| CASH AND CASH EQUIVALENTS — Beginning of period | 5,248 | 20,498 |
| CASH AND CASH EQUIVALENTS – End of period | \$6,915 | \$14,807 |

See accompanying notes to the condensed consolidated financial statements

GLOBAL WATER RESOURCES, INC.

Notes to the Condensed Consolidated Financial Statements (Unaudited)

1. BASIS OF PRESENTATION, CORPORATE TRANSACTIONS, SIGNIFICANT ACCOUNTING POLICIES, AND RECENT ACCOUNTING PRONOUNCEMENTS

Basis of Presentation and Principles of Consolidation

The condensed consolidated financial statements of Global Water Resources, Inc. (the “Company”, “GWRI”, “we”, “us”, or “our”) and related disclosures as of March 31, 2018 and for the three months ended March 31, 2018 and 2017 are unaudited. The December 31, 2017 condensed consolidated balance sheet data was derived from the Company’s audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (“U.S. GAAP”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These financial statements follow the same accounting policies and methods of their application as the Company’s most recent annual consolidated financial statements. These financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2017. In our opinion, these financial statements include all normal and recurring adjustments necessary for the fair statement of the results for the interim period. The results of operations for the three months ended March 31, 2018 are not necessarily indicative of the results to be expected for the full year, due to the seasonality of our business.

The Company prepares its financial statements in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”). The preparation of the financial statements in conformity with U.S. 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 date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. The U.S. dollar is the Company’s reporting currency and functional currency.

The Company qualifies as an “emerging growth company”, as defined in the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”), under the rules and regulations of the SEC. An emerging growth company may take advantage of specified reduced reporting and other requirements that are otherwise applicable generally to public companies. The Company elected to take advantage of these provisions for up to five years or such earlier time that the Company is no longer an emerging growth company. The Company has elected to take advantage of some of the reduced disclosure obligations regarding financial statements. Also, as an emerging growth company the Company can elect to delay adopting new or revised accounting standards issued subsequent to the enactment of the JOBS Act until such time as those standards apply to private companies. The Company has chosen to take advantage of this extended accounting transition provision.

Corporate Transactions

Sale of certain MXA and WMA contracts

In September 2013, the Company sold its Wastewater Facilities Main Extension Agreements (“MXA”) and Offsite Water Management Agreements (“WMA”) for the contemplated Loop 303 service area along with their related rights and obligations to EPCOR Water Arizona Inc. (“EPCOR”) (collectively the “Transfer of Project Agreement”, or “Loop 303 Contracts”). Pursuant to the Transfer of Project Agreement, EPCOR agreed to pay GWRI approximately \$4.1 million over a multi-year period. As part of the consideration, GWRI agreed to complete certain engineering work required in the WMAs, which work had been completed prior to January 1, 2015. As the engineering work has been completed, the Company effectively has no further obligations under the WMAs, the MXAs, or the Transfer of Project Agreement. Prior to January 1, 2015, the Company had received \$2.8 million of proceeds and recognized income of approximately \$3.3 million within other income (expense) in the statement of operations related to the gain on sale of these agreements and the proceeds received prior to January 1, 2015 for engineering work required in the WMAs. The Company received additional proceeds of approximately \$296,000 in April 2015 and recognized those amounts as income at that time. Receipt of the remaining \$1.0 million of proceeds will be recorded as additional income over time as certain milestones are met between EPCOR and the developers/landowners.

Merger with GWR Global Water Resources Corp. (“GWRC”)

On May 3, 2016, the Company completed the merger of GWRC into GWRI. At the time of the merger, GWRC ceased to exist as a British Columbia corporation and the Company continued as the surviving entity of the merger, (the "Reorganization Transaction"). In conjunction with the merger of GWRC into GWRI, the Company recorded an approximate \$1.4 million tax liability associated with the transfer of GWRC from Canada to the United States, which liability has since been settled.

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Private Letter Ruling

On June 2, 2016, the Company received a Private Letter Ruling from the Internal Revenue Service ("IRS") that, for purposes of deferring the approximately \$19.4 million gain realized from the condemnation of the operations and assets of Valencia Water Company, Inc. ("Valencia"), determined that the assets converted upon the condemnation of such assets could be replaced through certain reclamation facility improvements contemplated by the Company under Internal Revenue Code §1033 as property similar or related in service or use. In June 2016, the Company converted all operating subsidiaries from corporations to limited liability companies to take full advantage of the benefits of such ruling.

Pursuant to Internal Revenue Code §1033, the Company would have been able to defer the gain on condemnation through the end of 2017. On April 18, 2017, the Company filed a request for a one-year extension to defer the gain to the end of 2018, which the IRS approved on August 8, 2017. Following the approval of the extension, the Company has slightly modified the timing of certain planned investments within its capital improvement plan in accordance with Internal Revenue Code §1033. Accordingly, the Company substantially completed these investments in 2017, with some remaining improvements to be completed in the first half of 2018. As a result of the Private Letter Ruling, the Company increased capital expenditures in 2017 as compared to recent years, and expects corresponding reductions to occur in 2018, 2019, and beyond. As of March 31, 2018, our remaining deferred tax liability relating to the Valencia condemnation was approximately \$6.8 million. We plan to file another extension during 2018 which, if approved, will defer the gain to the end of 2019.

Acquisition of Eagletail Water Company

On May 15, 2017, the Company acquired Eagletail Water Company ("Eagletail") via merger. At the time of acquisition, Eagletail, a small water utility located west of metropolitan Phoenix, added approximately 55 active water connections and eight square miles of approved service area to the Company's existing regional service footprint. Total consideration was approximately \$80,000. As part of the transaction, the Company acquired assets of approximately \$80,000 and assumed liabilities of approximately \$78,000.

ACC Tax Docket

At March 31, 2018 and December 31, 2017, the Company had a regulatory asset and regulatory liability in the amount of \$1.9 million and \$0.6 million, respectively, related to the Federal Tax Cuts and Jobs Act (the "TCJA") signed into law on December 22, 2017. Under ASC Topic 740, Income Taxes, the tax effects of changes in tax laws must be recognized in the period in which the law is enacted. ASC 740 also requires deferred income tax assets and liabilities to be measured at the enacted tax rate expected to apply when temporary differences are to be realized or settled. Thus, at the date of enactment, the Company's deferred income taxes were re-measured based upon the new tax rate. For the Company's regulated entities, substantially all of the change in deferred income taxes is recorded as an offset to either a regulatory asset or liability because the impact of changes in the rates are expected to be recovered from or refunded to customers. The ACC is considering the impact for regulated utilities, as it is expected that certain effects of the TCJA add to rate base and others reduce rate base. On May 1, 2018, the ACC Chairman filed a letter in the ACC's docket concerning the TCJA, stating that "it appears that there may be some unintended consequences related to the tax treatment of contributions in aid of construction ("CIAC") and advances in aid of construction ("AIAC")" and that "[i]t is my intent that the Commission wait to move forward on adversely affected water and wastewater companies until we find a balanced approach." At this point, it is not clear what action the ACC will take regarding the TCJA issues. As a result, the Company cannot determine the effect of the TCJA on currently enacted rates.

Significant Accounting Policies

Basic and Diluted Earnings per Common Share

As of March 31, 2018, the Company had 717,678 options outstanding to acquire shares of the Company's common stock. The 275,000 options outstanding from the 2016 option grant provide 38,728 and 41,485 common share equivalents for the three months ended March 31, 2018 and 2017, respectively, which were included within the calculation of diluted earnings per share for each respective period. The 442,678 options outstanding from the 2017 option grant were not included for the three months ended March 31, 2018 dilutive earnings per share calculation, as to do so would be antidilutive. See Note 11 – "Deferred Compensation Awards" for additional information regarding the option grants.

Immaterial Correction of an Error in Previously Issued Financial Statements

Subsequent to the filing of the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2017, the Company identified prior period misstatements in stock compensation expense that resulted in the overstatement of general and administrative expense in the Company's consolidated statements of operations. The Company assessed the materiality of these misstatements both quantitatively and qualitatively and determined the correction of these errors to be immaterial to the prior consolidated financial statements taken as a whole. As a result, the Company has corrected the misstatements in the accompanying financial statements. The misstatements had no impact on the net cash flows from operating, investing, or financing activities.

The following tables summarize the impact of the correction to the prior financial statements (in thousands):

| | Three Months Ended March 31, 2017 (as Previously Reported) | Adjustments | March 31, 2017 (as Corrected) |
|-----------------------------------|--|-------------|--|
| General and administrative | 2,432 | (222) | 2,210 |
| Total operating expenses | 5,912 | (222) | 5,690 |
| Operating income | 879 | 222 | 1,101 |
| Income before income taxes | 137 | 222 | 359 |
| Income tax expense | (87) | (83) | (170) |
| Net income | 50 | 139 | 189 |
| Basic earnings per common share | — | 0.01 | 0.01 |
| Diluted earnings per common share | — | 0.01 | 0.01 |

| | March 31, 2017 (as Previously Reported) | Adjustments | March 31, 2017 (as Corrected) |
|--------------------------------------|---|-------------|--|
| Deferred income tax liabilities, net | \$ 2,440 | \$ 286 | \$ 2,726 |
| Total liabilities | 225,808 | 286 | 226,094 |
| Paid in capital | 18,506 | (763) | 17,743 |
| Accumulated deficit | (4,465) | 479 | (3,986) |
| Total shareholders' equity | 14,237 | (284) | 13,953 |

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"), which completes the joint effort between the FASB and International Accounting Standards Board to converge the recognition of revenue between the two boards. The new standard affects any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets not included within other FASB standards. The guiding principal of the new standard is that an entity should recognize revenue in an amount that reflects the consideration to which an entity expects to be entitled for the delivery of goods and services. ASU 2014-09 may be adopted using either of two acceptable methods: (1) retrospective adoption to each prior period presented with the option to elect certain practical expedients; or (2) adoption with the cumulative effect recognized at the date of initial application and providing certain disclosures. To assess at which time revenue should be recognized, an entity should use the following steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation. For public business entities, ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017,

including interim periods within the reporting period. For private companies, ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2018 and interim reporting periods beginning after December 15, 2019. Earlier application is allowed in certain circumstances. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2019. The Company does not believe this update will have an effect on the Company's regulated revenue. The American Institute of Certified Public Accountant's Power and Utility Entities Revenue Recognition Task Force has stated that nonexchange transactions, such as CIAC, are not within the scope of Topic 606, and, therefore, those transactions or events will continue to be recognized in accordance with other topics. Additionally, the Company is assessing the impact of ASU 2014-09 with regard to recognition of revenue received under infrastructure coordination and financing agreements ("ICFAs") in connection with substantial completion of capital improvements that will increase the capacity of Palo Verde's wastewater reclamation facility. The Company is evaluating whether this update will have an impact on the recognition

of ICFA revenue, which is recognized historically at the time wastewater capacity is completed to serve the property for which ICFA revenues were received.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”). ASU 2016-02 requires lessees to record a right-of-use asset and corresponding lease obligation for lease arrangements with a term of greater than twelve months. ASU 2016-02 requires additional disclosures about leasing arrangements and requires the use of the modified retrospective method, which will require adjustment to all comparative periods presented in the consolidated financial statements. This guidance will be effective for public companies for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. For all other entities, the guidance is effective for annual periods beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2020. The Company does not expect this update to have a material impact on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation – Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”). ASU 2016-09 identifies areas for simplification involving several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, an option to recognize gross stock compensation expense with actual forfeitures recognized as they occur, as well as certain classifications on the statement of cash flows. This guidance is effective for public companies for annual periods beginning after December 15, 2016 and interim periods within those annual periods. For all other entities, the guidance is effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. The Company adopted this accounting standard in the third quarter of 2017 and the adoption did not have a material effect on the Company’s consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). ASU 2016-15 clarifies and provides specific guidance on eight cash flow classification issues that are not currently addressed by current U.S. GAAP and thereby reduce the current diversity in practice. This guidance is effective for public companies for annual periods beginning after December 15, 2017 and interim periods within those annual periods. For all other entities, the guidance is effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2019. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740) Intra-Entity Transfers of Assets Other Than Inventory (“ASU 2016-16”). ASU 2016-16 instructs entities to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs (compared to current U.S. GAAP which prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party). The guidance is effective for public companies for annual periods beginning after December 15, 2017 and interim periods within those annual periods. For all other entities, the guidance is effective for annual periods beginning after December 15, 2018 and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2019. The guidance is required to be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force) (“ASU 2016-18”). ASU 2016-18 requires amounts generally described as restricted cash and restricted cash equivalents to be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. The guidance is effective for public companies for annual periods beginning after December 15, 2017, and interim periods within those annual periods. For all other entities, the guidance is effective for annual periods beginning after

December 15, 2018 and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted, including adoption in an interim period. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2019. The guidance should be applied using a retrospective transition method for each period presented. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business (“ASU 2017-01”). ASU 2017-01 provides a more robust framework to use in determining when a set of assets and activities is a business. Also the amendments provide more consistency in applying the guidance, reducing the costs of application, and make the definition of a business more operable. The guidance is effective for public companies for annual periods beginning after December 15, 2017, including interim periods within those periods. For all other entities, the guidance is effective for annual

periods beginning after December 15, 2018, and interim periods with annual periods beginning after December 15, 2019. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2019. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements.

2. REGULATORY DECISION AND RELATED ACCOUNTING AND POLICY CHANGES

Our regulated utilities and certain other balances are subject to regulation by the Arizona Corporation Commission ("ACC") and meet the requirements for regulatory accounting found within ASC Topic 980, Regulated Operations. In accordance with ASC Topic 980, rates charged to utility customers are intended to recover the costs of the provision of service plus a reasonable return in the same period. Changes to the rates are made through formal rate applications with the ACC, which we have done for all of our operating utilities and which are described below.

On July 9, 2012, we filed formal rate applications with the ACC to adjust the revenue requirements for seven utilities representing a collective rate increase of approximately 28% over 2011 revenue levels. In August 2013, the Company entered into a settlement agreement with ACC Staff, the Residential Utility Consumers Office, the City of Maricopa, and other parties to the rate case. The settlement required approval by the ACC's Commissioners before it could take effect. In February 2014, the rate case proceedings were completed and the ACC issued Rate Decision No. 74364, effectively approving the settlement agreement. The rulings of the decision include, but are not limited to, the following:

For the Company's utilities, adjusting for the condemnation of the operations and assets of Valencia and sale of Willow Valley Water Co., Inc. ("Willow Valley"), which occurred in 2015 and 2016, respectively, a collective revenue requirement increase of \$3.6 million based on 2011 test year service connections, phased-in over time, with the first increase in January 2015 as follows (in thousands):

| | Incremental | Cumulative |
|------|-------------|------------|
| 2015 | \$ 1,083 | \$ 1,083 |
| 2016 | 887 | 1,970 |
| 2017 | 335 | 2,305 |
| 2018 | 335 | 2,640 |
| 2019 | 335 | 2,975 |
| 2020 | 335 | 3,310 |
| 2021 | 335 | 3,645 |

Whereas this phase-in of additional revenues was determined using a 2011 test year, to the extent that the number of active service connections increases from 2011 levels, the additional revenues may be greater than the amounts set forth above. On the other hand, if active connections decrease or we experience declining usage per customer, we may not realize all of the anticipated revenues.

Full reversal of the imputation of CIAC balances associated with funds previously received under ICFAs, as required in the Company's last rate case. The reversal restored rate base or future rate base and had a significant impact of restoring shareholder equity on the balance sheet.

The Company has agreed to not enter into any new ICFAs. Existing ICFAs will remain in place, but a portion of future payments to be received under the ICFAs will be considered as hook-up fees, which are accounted for as CIAC once expended on plant.

A 9.5% return on common equity was adopted.

None of the Company's utilities will file another rate application before May 31, 2016. GWRI's subsidiaries, Global Water - Santa Cruz Water Company ("Santa Cruz") and Global Water - Palo Verde Utilities Company ("Palo Verde"), may not file for another rate increase before May 31, 2017.

The following provides additional discussion on accounting and policy changes resulting from Rate Decision No. 74364.

Infrastructure Coordination and Financing Agreements – ICFAs are agreements with developers and homebuilders whereby GWRI, the indirect parent of the operating utilities, provides services to plan, coordinate, and finance the water and wastewater infrastructure that would otherwise be required to be performed or subcontracted by the developer or homebuilder.

Under the ICFAs, GWRI has a contractual obligation to ensure physical capacity exists through its regulated utilities for water and wastewater to the landowner/developer when needed. This obligation persists regardless of connection growth. Fees for these

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services are typically a negotiated amount per equivalent dwelling unit for the specified development or portion of land. Payments are generally due in installments, with a portion due upon signing of the agreement, a portion due upon completion of certain milestones, and the final payment due upon final plat approval or sale of the subdivision. The payments are non-refundable. The agreements are generally recorded against the land and must be assumed in the event of a sale or transfer of the land. The regional planning and coordination of the infrastructure in the various service areas has been an important part of GWRI's business model.

Prior to January 1, 2010, GWRI accounted for funds received under ICFA as revenue once the obligations specified in the ICFA were met. As these arrangements are with developers and not with the end water or wastewater customer, the timing of revenue recognition coincided with the completion of GWRI's performance obligations under the agreement with the developer and with GWRI's ability to provide fitted capacity for water and wastewater service through its regulated subsidiaries.

The 2010 Regulatory Rate Decision No. 71878 established new rates for the recovery of reasonable costs incurred by the utilities and a return on invested capital. In determining the new annual revenue requirement, the ACC imputed a reduction to rate base for all amounts related to ICFA funds collected by the Company that the ACC deemed to be CIAC for rate making purposes. As a result of the decision by the ACC, GWRI changed its accounting policy for the accounting of ICFA funds. Effective January 1, 2010, GWRI recorded ICFA funds received as CIAC. Thereafter, the ICFA-related CIAC was amortized as a reduction of depreciation expense over the estimated depreciable life of the utility plant at the related utilities.

With the issuance of Rate Decision No. 74364, in February 2014, the ACC again changed how ICFA funds would be characterized and accounted for going forward. Most notably, the ACC changed the rate treatment of ICFA funds, and ICFA funds already received would no longer be deemed CIAC for rate making purposes. In conjunction with Rate Decision No. 74364, we eliminated the CIAC liability and reversed the associated regulatory liability brought about by the 2010 ruling. ICFA funds already received or which had become due prior to the date of Rate Decision No. 74364 were accounted for in accordance with the Company's ICFA revenue recognition policy that had been in place prior to the 2010 Regulatory Rate Decision, wherein the funds received are recognized as revenue once the obligations specified in the ICFA were met. Rate Decision No. 74364 prescribes that of the ICFA funds which come due and are paid subsequent to December 31, 2013, 70% of the ICFA funds will be recorded in the associated utility subsidiary as a hook-up fee ("HUF") liability, with the remaining 30% to be recorded as deferred revenue, which the Company accounts for in accordance with the Company's ICFA revenue recognition policy. A HUF tariff, specifying the dollar value of a HUF for each utility, was approved by the ACC as part of Rate Decision No. 74364. The Company is responsible for assuring the full HUF value is paid from ICFA proceeds, and recorded in its full amount, even if it results in recording less than 30% of the ICFA fee as deferred revenue.

The Company will account for the portion allocated to the HUF as a CIAC contribution. However, in accordance with the ACC directives the CIAC is not deducted from rate base until the HUF funds are expended for utility plant. Such funds will be segregated in a separate bank account and used for plant. A HUF liability will be established and will be amortized as a reduction of depreciation expense over the useful life of the related plant once the HUF funds are utilized for the construction of plant. For facilities required under a HUF or ICFA, the utilities must first use the HUF moneys received, after which, it may use debt or equity financing for the remainder of construction. The Company will record 30% of the funds received, up until the HUF liability is fully funded, as deferred revenue, which is to be recognized as revenue once the obligations specified within the ICFA are met, including construction of sufficient operating capacity to serve the customers for which revenue was deferred. As of March 31, 2018 and December 31, 2017, ICFA deferred revenue recorded on the consolidated balance sheet totaled \$19.7 million, which represents deferred revenue recorded for ICFA funds received on contracts that had become due prior to Rate Decision No. 74364. For ICFA contracts coming due after December 31, 2013, as funding is received 30% will be added to this balance with the remaining 70% recorded to a HUF liability, until the HUF liability is fully funded at which time any funding greater than the HUF liability will be recorded as deferred revenue.

Intangible assets / Regulatory liability – The Company previously recorded certain intangible assets related to ICFA contracts obtained in connection with our Santa Cruz, Palo Verde, and Sonoran acquisitions. The intangible assets represented the benefits to be received over time by virtue of having those contracts. Prior to January 1, 2010, the

ICFA-related intangibles were amortized when ICFA funds were recognized as revenue. Effective January 1, 2010, in connection with the 2010 Regulatory Rate Decision, these assets became fully offset by a regulatory liability of \$11.2 million since the imputation of ICFA funds as CIAC effectively resulted in the Company not being able to benefit (through rates) from the acquired ICFA contracts.

Effective January 1, 2010, the gross ICFA intangibles began to be amortized when cash was received in proportion to the amount of total cash expected to be received under the underlying agreements. However, such amortization expense was offset by a corresponding reduction of the regulatory liability in the same amount.

As a result of Rate Decision No. 74364, the Company changed its policy around the ICFA related intangible assets. As discussed above, pursuant to Rate Decision No. 74364, approximately 70% of ICFA funds to be received in the future will be recorded as a HUF, until the HUF is fully funded at the Company's applicable utility subsidiary. The remaining approximate 30% of future ICFA

funds will be recorded at the parent company level and will be subject to the Company's ICFA revenue recognition accounting policy. As the Company now expects to experience an economic benefit from the approximately 30% portion of future ICFA funds, 30% of the regulatory liability, or \$3.4 million, was reversed in 2014. The remaining 70% of the regulatory liability, or \$7.9 million, will continue to be recorded on the balance sheet.

Subsequent to Rate Decision No. 74364, the intangible assets will continue to amortize when the corresponding ICFA funds are received in proportion to the amount of total cash expected to be received under the underlying agreements. The recognition of amortization expense will be partially offset by a corresponding reduction of the regulatory liability.

3. PROPERTY, PLANT AND EQUIPMENT

Property, plant, and equipment at March 31, 2018 and December 31, 2017 consist of the following (in thousands):

| | March 31, 2018 | December 31, 2017 | Average Depreciation Life (in years) |
|---|-------------------|----------------------|--------------------------------------|
| Mains/lines/sewers | \$117,418 | \$117,381 | 47 |
| Plant | 71,698 | 72,863 | 25 |
| Equipment | 29,725 | 29,904 | 10 |
| Meters | 12,628 | 12,693 | 12 |
| Furniture, fixture and leasehold improvements | 371 | 368 | 8 |
| Computer and office equipment | 603 | 720 | 5 |
| Software | 241 | 242 | 3 |
| Land and land rights | 861 | 861 | |
| Other | 426 | 428 | |
| Construction work-in-process | 53,189 | 53,591 | |
| Total property, plant and equipment | 287,160 | 289,051 | |
| Less accumulated depreciation | (74,394) | (75,592) | |
| Net property, plant and equipment | \$212,766 | \$213,459 | |

4. ACCOUNTS RECEIVABLE

Accounts receivable as of March 31, 2018 and December 31, 2017 consist of the following (in thousands):

| | March 31, 2018 | December 31, 2017 |
|---|----------------------|----------------------|
| Billed receivables | \$1,531 | \$ 1,691 |
| Less allowance for doubtful accounts (177) | (177) | (163) |
| Accounts receivable – net | \$1,354 | \$ 1,528 |

5. EQUITY METHOD INVESTMENT

On June 5, 2013, the Company sold Global Water Management, LLC ("GWM"), a wholly-owned subsidiary of GWRI, that owned and operated the FATHOM Water Management Holdings, LLP ("FATHOM™") business. In connection with the sale of GWM, the Company made a \$1.6 million investment in FATHOM™ (the "FATHOM™ investment"). This limited partnership investment is accounted for under the equity method due to the FATHOM™ investment being considered more than minor.

In March 2017, FATHOM™ completed a round of financing, wherein our ownership percentage was reduced from 8.0% to 7.1% on a fully diluted basis. In conjunction with the recapitalization, the Company's equity interest was adjusted in accordance with ASC 323, Investments-Equity Method and Joint Ventures, wherein we recorded a \$243,000 gain for the three months ended March 31, 2017. The adjustment to the carrying value of the FATHOM™ investment was calculated using our proportionate share of FATHOM™'s adjusted net equity. The gain was recorded within other income and expense in our consolidated statement of operations in the first quarter of 2017. The carrying value of the FATHOM™ investment consisted of a balance of \$234,000 as of March 31, 2018 and \$345,000 as of December 31, 2017, and reflects our initial investment, the adjustments related to subsequent rounds of financing, and our proportionate share of FATHOM™'s cumulative earnings (losses).

We evaluate the FATHOM™ investment for impairment whenever events or changes in circumstances indicate that the carrying value of the FATHOM™ investment may have experienced an “other-than-temporary” decline in value. Since the sale of GWM, the losses incurred on the FATHOM™ investment were greater than anticipated; however, based upon our evaluation of various

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relevant factors, including the most recent round of financing and the ability of FATHOM™ to achieve and sustain an earnings capacity that would justify the carrying amount of the FATHOM™ investment, we do not believe the FATHOM™ investment to be impaired as of March 31, 2018.

We have evaluated whether the FATHOM™ investment qualifies as a variable interest entity (“VIE”) pursuant to the accounting guidance of ASC 810, Consolidations. Considering the potential that the total equity investment in the FATHOM™ investment may not be sufficient to absorb the losses of the FATHOM™ investment, the Company currently views the FATHOM™ investment as a VIE. However, considering the Company’s minority interest and limited involvement with the FATHOM™ business, the Company is not required to consolidate FATHOM™. Rather, the Company has accounted for the FATHOM™ investment under the equity method.

6. INTANGIBLE ASSETS

Intangible assets as of March 31, 2018 and December 31, 2017 consisted of the following (in thousands):

| | March 31, 2018 | | | December 31, 2017 | | |
|--|----------------|--------------------------|------------|-------------------|--------------------------|------------|
| | Gross Amount | Accumulated Amortization | Net Amount | Gross Amount | Accumulated Amortization | Net Amount |
| INDEFINITE LIVED INTANGIBLE ASSETS: | | | | | | |
| CP Water Certificate of Convenience & Necessity service area | \$1,532 | \$ — | \$1,532 | \$1,532 | \$ — | \$1,532 |
| Intangible trademark | 13 | — | 13 | 13 | — | 13 |
| | 1,545 | — | 1,545 | 1,545 | — | 1,545 |
| AMORTIZED INTANGIBLE ASSETS: | | | | | | |
| Acquired ICFAs | 17,978 | (12,154) | 5,824 | 17,978 | (12,154) | 5,824 |
| Sonoran contract rights | 7,406 | (2,003) | 5,403 | 7,406 | (2,003) | 5,403 |
| | 25,384 | (14,157) | 11,227 | 25,384 | (14,157) | 11,227 |
| Total intangible assets | \$26,929 | \$ (14,157) | \$12,772 | \$26,929 | \$ (14,157) | \$12,772 |

Acquired ICFAs and contract rights related to our 2005 acquisition of Sonoran Utility Services, LLC assets are amortized when cash is received in proportion to the amount of total cash expected to be received under the underlying agreements. Due to the uncertainty of the timing of when cash will be received under ICFA agreements and contract rights, we cannot reliably estimate when the remaining intangible assets' amortization will be recorded. No amortization was recorded for these balances for the three months ended March 31, 2018 and March 31, 2017.

7. TRANSACTIONS WITH RELATED PARTIES

The Company provides medical benefits to our employees through our participation in a pooled plan sponsored by an affiliate of a shareholder and director of the Company. Medical claims paid to the plan were approximately \$62,000 and \$90,000 for the three months ended March 31, 2018 and 2017, respectively.

GWM has historically provided billing, customer service, and other support services for the Company’s regulated utilities. Amounts collected by GWM from the Company’s customers that GWM has not yet remitted to the Company are included within the “Due from affiliates” caption on the Company’s consolidated balance sheet. As of March 31, 2018 and December 31, 2017, the unremitted balance totaled \$463,000 and \$430,000, respectively. Notwithstanding the sale of GWM on June 5, 2013, GWM continues to provide these services to the Company’s regulated utilities under a long-term service agreement. Based on current service connections, annual fees to be paid to GWM for FATHOM™ services will be approximately \$1.5 million at a rate of \$6.24 per water account/month. For each of the three months ended March 31, 2018 and 2017, the Company incurred FATHOM™ service fees of approximately \$0.4 million.

In addition, the Company entered into a services agreement with GWM whereby the Company has agreed to use the FATHOM™ platform for all of its regulated utility services for an initial term of 10 years. The services agreement was amended on November 17, 2016, which extended the term of the contract through December 31, 2026. As part of the amended agreement, the Company reduced the monthly rate per connection from \$7.79 per water account/month to \$6.24 per water account/month. Additionally, the scope of services was expanded to include a meter replacement program of approximately \$11.4 million, wherein the Company replaced a majority of its meter infrastructure. As of March 31, 2018, \$10.7 million has been paid to GWM in connection with the meter exchange program.

The services agreement is automatically renewable for successive 10-year periods, unless notice of termination is given prior to any renewal period. The services agreement may be terminated by either party for default only and the termination of the services agreement will also result in the termination of the royalty payments (described below) payable to the Company. Pursuant to the purchase agreement for the sale of GWM, the Company is entitled to quarterly royalty payments based on a percentage of certain of GWM's recurring revenues for a 10-year period, up to a maximum of \$15.0 million. The Company made the election to record these quarterly royalty payments prospectively in income as the amounts are earned. Royalties recorded within other income totaled approximately \$108,000 and \$92,000 for the three months ended March 31, 2018 and 2017, respectively.

8. ACCRUED EXPENSES

Accrued expenses at March 31, 2018 and December 31, 2017 consist of the following (in thousands):

| | March 31, 2018 | December 31, 2017 |
|--|----------------------|----------------------|
| Deferred compensation | \$1,666 | \$ 2,171 |
| Property taxes | 514 | 989 |
| Meter replacement - related party | 717 | 717 |
| Interest | 1,771 | 468 |
| Dividend payable | 464 | 464 |
| Asset retirement obligation | 427 | 427 |
| Deferred phantom units eligible for exercise | 424 | — |
| Other accrued liabilities | 1,849 | 2,016 |
| Total accrued expenses | \$7,832 | \$ 7,252 |

9. DEBT

The outstanding balances and maturity dates for short-term (including the current portion of long-term debt) and long-term debt as of March 31, 2018 and December 31, 2017 are as follows (in thousands):

| | March 31, 2018 | | December 31, 2017 | |
|---|----------------|-----------|----------------------|-----------|
| | Short-term | Long-term | Short-term | Long-term |
| BONDS AND NOTES PAYABLE - | | | | |
| 4.380% Series A 2016, maturing June 2028 | \$— | \$28,750 | \$— | \$28,750 |
| 4.580% Series B 2016, maturing June 2036 | — | 86,250 | — | 86,250 |
| 1.200% WIFA Loan, maturing October 2032 | 3 | 41 | 3 | 41 |
| 4.650% Harquahala Loan, maturing January 2021 | 5 | 13 | 5 | 15 |
| | 8 | 115,054 | 8 | 115,056 |
| OTHER | | | | |
| Capital lease obligations | 21 | 72 | — | — |
| Debt issuance costs | — | (682) | — | (693) |
| Total debt | \$29 | \$114,444 | \$8 | \$114,363 |

2016 Senior Secured Notes

On June 24, 2016, the Company issued two series of senior secured notes with an aggregate total principal balance of \$115.0 million at a blended interest rate of 4.55%. Series A carries a principal balance of \$28.8 million and bears an interest rate of 4.38% over a twelve year term, with the principal payment due on June 15, 2028. Series B carries a principal balance of \$86.3 million and bears an interest rate of 4.58% over a 20-year term. Series B is interest only for the first five years, with \$1.9 million principal payments paid semiannually thereafter. The proceeds of the senior secured notes were primarily used to refinance the previously outstanding long-term tax exempt bonds, which were subject to an early redemption option at 103%, plus accrued interest, as a result of the initial public offering of our common stock in May 2016 (the "U.S. IPO"). As part of the refinancing of the long-term debt, the Company paid a prepayment penalty of \$3.2 million and wrote off the remaining \$2.2 million in capitalized loan fees related to the tax exempt bonds, which were recorded as additional interest expense in the second quarter of 2016. The senior secured

notes are collateralized by a security interest in the Company's equity interest in its subsidiaries, including all payments representing profits and qualifying distributions.

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The senior secured notes require the Company maintain a debt service coverage ratio of consolidated EBITDA to consolidated debt service of at least 1.10 to 1.00. Consolidated EBITDA is calculated as net income plus depreciation, taxes, interest and other non-cash charges net of non-cash income. Consolidated debt service is calculated as interest expense, principal payments, and dividend or stock repurchases. The senior secured notes also contain a provision limiting the payment of dividends if the Company falls below a debt service ratio of 1.25. However, for the quarter ending June 30, 2021 through the quarter ending March 31, 2024, the ratio drops to 1.20. As of March 31, 2018, the Company was in compliance with its financial debt covenants.

Eagletail Loans

In May 2017, the Company acquired Eagletail. As part of the acquisition, the Company assumed two unsecured loans held by Eagletail. These loans are payable to the Water Infrastructure Finance Authority of Arizona ("WIFA") and Harquahala Valley Community Benefits Foundation ("Harquahala"). Refer to the table above for carrying balances as of March 31, 2018. The WIFA loan bears an interest rate of 1.20% over a 20-year term, while the Harquahala loan bears an interest rate of 4.65% over a 15-year term.

At March 31, 2018, the remaining aggregate annual maturities of debt and minimum lease payments under capital lease obligations for the years ended December 31 are as follows (in thousands):

| | Debt | Capital Lease Obligations |
|------------------------------------|-----------|---------------------------------|
| 2018 | \$6 | \$ 21 |
| 2019 | 8 | 27 |
| 2020 | 9 | 27 |
| 2021 | 1,922 | 27 |
| 2022 | 3,836 | 5 |
| Thereafter | 109,281 | — |
| Subtotal | 115,062 | 107 |
| Less: amount representing interest | — | (14) |
| Total | \$115,062 | \$ 93 |

At March 31, 2018, the outstanding principal value of the non-current portion of long-term debt was \$115.1 million, with an estimated fair value of \$112.5 million. At December 31, 2017, the carrying value of the non-current portion of long-term debt was \$115.1 million, with an estimated fair value of \$115.7 million. The fair value of our debt was estimated based on interest rates considered available for instruments of similar terms and remaining maturities.

10. INCOME TAXES

During the three months ended March 31, 2018, the Company recorded a tax expense of \$141,000 on a pre-tax income of \$461,000, compared to a tax expense of \$170,000 on a pre-tax income of \$359,000 for the three months ended March 31, 2017. The income tax provision was computed based on the Company's estimated effective tax rate, reflective of the TCJA new federal rates, and forecasted income expected for the full year, including the impact of any unusual, infrequent, or non-recurring items.

11. DEFERRED COMPENSATION AWARDS

Stock-based compensation

Stock-based compensation related to option awards is measured based on the fair value of the award. The fair value of stock option awards is determined using a Black-Scholes option-pricing model. We recognize compensation expense associated with the options over the vesting period.

2016 stock option grant

In May 2016, GWRI's Board of Directors granted stock options to acquire 325,000 shares of GWRI's common stock to the members of the board. The options were granted with an exercise price of \$7.50, the market price of the Company's common shares on the NASDAQ Global Market at the close of business on May 20, 2016. The options vest over a two-year period, with 50% vesting in May 2017 and 50% vesting in May 2018. The options have a three-year life. The Company will expense the \$348,000 fair value of the stock option grant ratably over the two-year vesting period in accordance with ASC 323. Stock-based compensation expense of \$43,000 was recorded in each of

the three months ended March 31, 2018 and 2017. As of March 31, 2018, 50,000 options have been exercised with 275,000 outstanding.

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2017 stock option grant

In August 2017, GWRI's Board of Directors granted stock options to acquire 465,000 shares of GWRI's common stock to employees throughout the Company. The options were granted with an exercise price of \$9.40, the market price of the Company's common shares on the NASDAQ Global Market at the close of business on August 10, 2017. The options vest over a four-year period, with 25% vesting in August 2018, 25% vesting in August 2019, 25% vesting in August 2020, and 25% vesting in August 2021. The options have a 10-year life. The Company will expense the remaining \$1.1 million fair value of the stock option grant ratably over the four-year vesting period in accordance with ASC 323. Stock-based compensation expense of \$54,000 was recorded for three months ended March 31, 2018. As of March 31, 2018, 51,000 options have been forfeited with 409,400 outstanding.

Phantom stock compensation

On December 30, 2010, we adopted a phantom stock unit plan authorizing the directors of the Company to issue phantom stock units ("PSUs") to our employees. Following the consummation of the Reorganization Transaction, the awarded PSUs have been amended such that the outstanding units track the value of GWRI's share price. The vesting of the awards has not changed. The PSUs give rise to a right of the holder to receive a cash payment the value of which, on a particular date, is the market value of the equivalent number of shares of GWRI at that date. The issuance of PSUs as a core component of employee compensation was intended to strengthen the alignment of interests between the employees of the Company and the shareholders of GWRI by linking their holdings and a portion of their compensation to the future value of the common shares of GWRI.

PSUs are accounted for as liability compensatory awards under ASC 710, Compensation – General, rather than as equity awards. PSU awards are remeasured each period and a liability is recorded equal to GRWI's closing share price as of the balance sheet date multiplied by the number of units vested and outstanding. The value of the benefits is recorded as an expense in the Company's financial statements over the related vesting period. Vesting occurs ratably over 12 consecutive quarters beginning in the period granted. The following table details total awards granted and the number of units outstanding as of March 31, 2018 along with the amounts paid to holders of the PSUs for the three months ended March 31, 2018 and 2017 (in thousands, except unit amounts):

| Grant Date | Units Granted | Units Outstanding | Amounts Paid For the Three Months Ended March 31, | |
|------------|------------------|----------------------|--|------|
| | | | 2018 | 2017 |
| Q1 2015 | 28,828 | — | \$22 | \$22 |
| Q1 2016 | 34,830 | 11,610 | 27 | 26 |
| Q1 2017 | 22,712 | 15,141 | 17 | — |
| Q1 2018 | 30,907 | 30,907 | \$— | \$— |
| Total | 117,277 | 57,658 | \$66 | \$48 |

Stock appreciation rights compensation

Beginning January 2012, in an effort to reward employees for their performance, the Company adopted a stock appreciation rights plan authorizing the directors of the Company to issue stock appreciation rights ("SARs") to our employees. Following the consummation of the Reorganization Transaction, the value of the SARs issued under the plan track the performance of GWRI's shares. Each holder has the right to receive a cash payment amounting to the difference between the exercise price and the closing price of GWRI's common shares on the exercise date, provided that the closing price is in excess of the exercise price. Holders of SARs may exercise their awards once vested. Individuals who voluntarily or involuntarily leave the Company forfeit their rights under the awards.

The following table details the recipients of the SARs awards, the grant date, units granted, exercise price, outstanding shares as of March 31, 2018 and amounts paid during the three months ended March 31, 2018 and 2017 (in thousands, except unit and per unit amounts):

| Recipients | Grant Date | Units Granted | Exercise Price | Units Outstanding | Amounts Paid For the Three Months Ended March 31, | |
|---|------------|------------------|-------------------|----------------------|--|-------|
| | | | | | 2018 | 2017 |
| Key Executive ⁽¹⁾⁽³⁾ | Q3 2013 | 100,000 | \$ 1.59 | — | \$166 | \$181 |
| Key Executive ⁽¹⁾⁽⁴⁾ | Q4 2013 | 100,000 | \$ 2.69 | — | 183 | 154 |
| Members of Management ⁽¹⁾⁽⁵⁾ | Q1 2015 | 299,000 | \$ 4.26 | 183,000 | — | — |
| Key Executives ⁽²⁾⁽⁶⁾ | Q2 2015 | 300,000 | \$ 5.13 | 300,000 | — | — |
| Members of Management ⁽¹⁾⁽⁷⁾ | Q3 2017 | 103,000 | \$ 9.40 | 103,000 | — | — |
| Members of Management ⁽¹⁾⁽⁸⁾ | Q1 2018 | 33,000 | \$ 8.99 | 33,000 | — | — |
| Total | | 935,000 | | 619,000 | \$349 | \$335 |

(1) The SARs vest ratably over sixteen quarters from the grant date.

(2) The SARs vest over sixteen quarters, vesting 20% per year for the first three years, with the remainder, 40%, vesting in year four.

(3) The exercise price was determined by taking the weighted average GWRC share price of the five days prior to the grant date of July 1, 2013.

(4) The exercise price was determined by taking the weighted average GWRC share price of the 30 days prior to the grant date of November 14, 2013.

(5) The exercise price was determined to be the fair market value of one share of GWRC stock on the grant date of February 11, 2015.

(6) The exercise price was determined to be the fair market value of one share of GWRC stock on the grant date of May 8, 2015.

(7) The exercise price was determined to be the fair market value of one share of GWRI stock on the grant date of August 10, 2017.

(8) The exercise price was determined to be the fair market value of one share of GWRI stock on the grant date of March 12, 2018.

As a result of the merger of GWRC into the Company and the U.S. IPO, the exercise prices for the preceding awards were translated to U.S. dollars using the prevailing noon-day Bank of Canada foreign exchange rate of US\$0.7969 per CAD\$1.00 as measured on May 2, 2016, the day prior to the closing of the merger. The vesting of the awards has not changed. Subsequent to the merger, each SAR provides the holder the right to receive a cash payment amounting to the difference between the per share exercise price and the closing price of GWRI's common shares on the exercise date, provided that the closing price is in excess of exercise price per share.

For the three months ended March 31, 2018 and 2017, the Company recorded approximately \$0.2 million of income and \$0.2 million of compensation expense related to the PSUs and SARs, respectively. Based on GWRI's closing share price on March 29, 2018, deferred compensation expense to be recognized over future periods is estimated for the years ending December 31 as follows (in thousands):

| | PSUs | SARs |
|------|--------|--------|
| 2018 | \$ 197 | \$ 636 |
| 2019 | \$ 159 | \$ 215 |
| 2020 | 91 | 82 |
| 2021 | — | 67 |

2022 — 5
Total \$ 447 \$ 1,005

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12. SUPPLEMENTAL CASH FLOW INFORMATION

The following is supplemental cash flow information for the three months ended March 31, 2018 and 2017 (in thousands):

| | For the Three Months Ended March 31, | |
|---|--|---------|
| | 2018 | 2017 |
| Supplemental cash flow information: | | |
| Cash paid for interest | \$2 | \$8 |
| Cash paid for GWRC tax liability | \$— | \$125 |
| Non-cash financing and investing activities: | | |
| Capital expenditures included in accounts payable and accrued liabilities | \$1,069 | \$4,839 |
| Equity method investment gain on recapitalization of FATHOM™ | \$— | \$243 |

13. COMMITMENTS AND CONTINGENCIES

Commitments

Prior to the sale of GWM, we leased certain office space in Arizona under operating leases with terms that expired in February 2016. The operating lease agreements were between GWM and the landlord. Accordingly, effective June 2013 through February 2016, the Company was not a party under the lease agreements. GWRI subleased a portion of the office space covered under the GWM lease agreements. In February 2016, the Company entered into a three-year lease agreement with the landlord to occupy the same space previously subleased under GWM's lease agreements, inclusive of necessary facility upgrades. Beginning in March 2016, the Company began recording approximately \$8,000 in monthly rent expense related to the new agreement. Rent expense arising from the operating leases totaled approximately \$24,000 and \$25,000 for the three months ended March 31, 2018 and 2017, respectively.

Contingencies

From time to time, in the ordinary course of business, the Company may be subject to pending or threatened lawsuits in which claims for monetary damages are asserted. Management is not aware of any legal proceeding of which the ultimate resolution could materially affect our financial position, results of operations, or cash flows.

14. SUBSEQUENT EVENTS

Line of Credit

On April 20, 2018, the Company entered into an agreement with MidFirst Bank, a federally chartered savings association, for a two-year revolving line of credit up to \$8.0 million. The credit facility, which will be used for acquisitions and general corporate purposes, will bear an interest rate of LIBOR plus 2.25%.

Definitive Agreement to Purchase Turner Ranches Water and Sanitation Company

On April 25, 2018, the Company signed a definitive agreement to acquire Turner Ranches Water and Sanitation Company ("Turner"), a non-potable irrigation water utility in Mesa, Arizona for a purchase price of \$2.8 million. Turner currently has 960 residential irrigation connections and approximately seven square miles of service area, including three golf courses. The acquisition is expected to close in the second quarter of 2018, subject to customary closing conditions and regulatory approval.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following management's discussion and analysis of Global Water Resources, Inc.'s (the "Company", "GWRI", "we", or "us") financial condition and results of operations relates to the three months ended March 31, 2018 and should be read together with the condensed consolidated financial statements and accompanying notes included herein, as well as our audited annual financial statements and associated management's discussion, which are available within our Annual Report on Form 10-K for the year ended December 31, 2017 available on our Company's profile on the Securities and Exchange Commission ("SEC") website, www.sec.gov.

Cautionary Statement Regarding Forward-Looking Statements

Certain statements in this management's discussion and analysis are forward-looking in nature and may constitute "forward-looking information" within the meaning of applicable securities laws. Often, but not always, forward-looking statements can be identified by the words "believes", "anticipates", "plans", "expects", "intends", "projects", "estimates", "objectives", "goal", "focus", "aim", "should", "could", "may", and similar expressions. These forward-looking statements include future estimates described in "Business Outlook", "Factors Affecting our Results of Operations," and "Liquidity and Capital Resources". These forward-looking statements reflect management's current expectations regarding GWRI's future growth, results of operations, performance and business prospects and opportunities and other future events and speak only as of the date of this management's discussion and analysis. Forward-looking statements should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not or the times at or by which such performance or results will be achieved. Investors are cautioned not to place undue reliance on forward-looking information. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed under "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC, as updated from time to time in our subsequent filings with the SEC. Although the forward-looking statements contained in this management's discussion and analysis are based upon what management believes to be reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward-looking statements, and the differences may be material. These forward-looking statements are made as of the date of this management's discussion and analysis and GWRI assumes no obligation to update or revise them to reflect new events or circumstances, except as required by applicable law.

Overview

We are a water resource management company that owns, operates, and manages water, wastewater, and recycled water utilities in strategically located communities, principally in metropolitan Phoenix, Arizona. We seek to deploy our integrated approach, which we refer to as "Total Water Management," a term we use to mean managing the entire water cycle by owning and operating the water, wastewater, and recycled water utilities within the same geographic areas in order to both conserve water and maximize its total economic and social value. We use Total Water Management to promote sustainable communities in areas where we expect growth to outpace the existing potable water supply. Our model focuses on the broad issues of water supply and scarcity and applies principles of water conservation through water reclamation and reuse. Our basic premise is that the world's water supply is limited and yet can be stretched significantly through effective planning, the use of recycled water, and by providing individuals and communities resources that promote wise water usage practices.

Business Outlook

2017 and the first quarter of 2018 continued the trend of positive growth in new connections. According to the 2010 U.S. Census Data, the Phoenix metropolitan statistical area ("MSA") is the 14th largest MSA in the U.S. and had a population of 4.2 million, an increase of 29% over the 3.3 million people reported in the 2000 Census. Metropolitan Phoenix continues to grow due to its low-cost housing, excellent weather, large and growing universities, a diverse employment base, and low taxes. The Employment and Population Statistics Department of the State of Arizona predicts that the Phoenix Metro will have a population of 4.9 million people by 2020 and 6.8 million by 2040. During the twelve months ended March 31, 2018, Arizona's employment rate improved by 3.3%, ranking the state in the top five nationally for job growth.

Also, according to the W.P. Carey School of Business Greater Phoenix Blue Chip Real Estate Consensus Panel, most sectors of real estate are expected to experience improved growth with industrial and retail sectors also expected to

experience improved occupancy rates. For Maricopa County and Pinal County combined, the W.P. Carey School of Business, using U.S. Census data, reported that single family housing permits were approximately 20,695 units for 2017.

The forecasts by the Greater Phoenix Blue Chip Real Estate Consensus Panel for 2018 and 2019 remain positive at approximately 24,000 and 27,000 single family dwelling permits, respectively. From there, we believe growth in the region could steadily return towards its normal historical rate of greater than 30,000 single family dwelling permits.

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We believe that our utilities and service areas are directly in the anticipated path of growth primarily in the metropolitan Phoenix area. Market data indicates that our service areas currently incorporate a large portion of the final platted lots, partially finished lots, and finished lots in metropolitan Phoenix. Management believes that we are well-positioned to benefit from the near-term growth in metropolitan Phoenix due to the availability of lots and existing infrastructure in place within our services areas.

Factors Affecting our Results of Operations

Our financial condition and results of operations are influenced by a variety of industry-wide factors, including but not limited to:

- population and community growth;
- economic and environmental utility regulation;
- economic environment;
- the need for infrastructure investment;
- production and treatment costs;
- weather and seasonality; and
- access to and quality of water supply.

We are subject to economic regulation by the state regulator, the Arizona Corporation Commission (“ACC”). The U.S. federal and state governments also regulate environmental, health and safety, and water quality matters. We continue to execute on our strategy to optimize and focus the Company in order to provide greater value to our customers and shareholders by aiming to deliver predictable financial results, making prudent capital investments, and focusing our efforts on earning an appropriate rate of return on our investments.

Population and Community Growth

Population and community growth in the metropolitan Phoenix area served by our utilities have a direct impact on our earnings. An increase or decrease in our active service connections will affect our revenues and variable expenses in a corresponding manner. Our total service connections, including both active service connections and connections to vacant homes, increased 1,873 connections, or 4.9%, from a total of 38,290 as of March 31, 2017 to 40,163 as of March 31, 2018, an annualized increase of approximately 5.5%. This increase is due primarily to the positive growth in new connections.

As of March 31, 2018, we have 39,542 active service connections compared to 37,687 active service connections as of March 31, 2017, an increase of 1,855, or 4.9%. As with the increase in total service connections, the increase is due primarily to the growth in new connections as well as re-establishing connections on existing homes. Approximately 98.8% of the 39,542 active service connections are serviced by our Global Water - Santa Cruz Water Company, LLC (“Santa Cruz”) and Global Water - Palo Verde Utilities Company, LLC (“Palo Verde”) utilities as of March 31, 2018. The graph below presents the historical change in active and total connections for our ongoing operations, adjusting for the July 2015 condemnation of the assets and operations of Valencia Water Company, Inc. (“Valencia”) and the May 2016 sale of Willow Valley Water Co., Inc. (“Willow Valley”).

During the economic downturn beginning in 2008, our utilities experienced an increase in the number of vacant homes, reaching a peak of 4,020 vacant connections as of February 28, 2009, approximately 11.2% of our total connections at the time; however, the negative trend began to reverse thereafter with the number of vacant homes decreasing to 621 or 1.5% of total connections as of March 31, 2018.

Economic and Environmental Utility Regulation

We are subject to extensive regulation of our rates by the ACC, which is charged with establishing rates based on the provision of reliable service at a reasonable cost while also providing an opportunity to earn a fair rate of return on rate base for investors of utilities. The ACC uses a historical test year to evaluate whether the plant in service is used and useful, to assess whether costs were prudently incurred, and to set “just and reasonable” rates. Rate base is typically the depreciated original cost of the plant in service (net of contributions in aid of construction (“CIAC”) and advances in aid of construction (“AIAC”) which are funds or property provided to a utility under the terms of a main extension agreement, the value of which may be refundable), that has been determined to have been “prudently invested” and “used and useful”, although the reconstruction cost of the utility plant may also be considered in determining the rate base. The ACC also decides on an applicable capital structure based on actual or hypothetical analyses. The ACC determines a “rate of return” on that rate base, which includes the approved capital structure and the actual cost of debt and a fair and reasonable cost of equity based on the ACC's judgment. The overall revenue requirement for rate making purposes is established by multiplying the rate of return by the rate base and adding “prudently” incurred operating expenses for the test year, depreciation, and any applicable pro forma adjustments.

To ensure an optimal combination of access to water and water conservation balanced with a fair rate of return for investors, our water utility operating revenue is based on two components: a fixed fee and a consumption or volumetric fee. For our water utilities, the fixed fee, or “basic service charge,” provides access to water for residential usage and has generally been set at a level to produce 50% of total revenue. The volumetric fee is based on the total volume of water supplied to a given customer after the minimum number of gallons, if any, covered by the basic service charge, multiplied by a price per gallon set by a tariff approved by the ACC. A discount to the volumetric rate applies for customers that use less than an amount specified by the ACC. For all investor-owned water utilities, the ACC requires the establishment of inverted tier conservation oriented rates, meaning that the price of water increases as consumption increases. For wastewater utilities, wastewater collection, and treatment can be based on volumetric or fixed fees. Our wastewater utility services are billed based solely on a fixed fee, determined by the size of the water meter installed. Recycled water is sold on a volumetric basis with no fixed fee component.

We are required to file rate cases with the ACC to obtain approval for a change in rates. Rate cases and other rate-related proceedings can take a year or more to complete. As a result, there is frequently a delay, or regulatory lag, between the time of a capital investment or incurrence of an operating expense increase and when those costs are reflected in rates. In normal conditions, it would not be uncommon to see us file for a rate increase every three years based on year one being the test year, year two being the rate case filing year, and year three being the rate case award year. However, based on our settlement with the ACC and extended new rate phase-in period, we will not be initiating the next rate case on this timeline. Moving forward, we will continue to analyze all factors that drive the requirement for increased revenue, including our rate of investment and recurring expenses, and determine the appropriate test year for a future rate case. See “—Rate Case Activity” for additional information.

Our water and wastewater operations are also subject to extensive United States federal, state, and local laws and regulations governing the protection of the environment, health and safety, the quality of the water we deliver to our customers, water allocation rights, and the manner in which we collect, treat, and discharge wastewater. We are also required to obtain various environmental permits from regulatory agencies for our operations. The ACC also sets conditions and standards for the water and wastewater services we deliver. We incur substantial costs associated with compliance with environmental, health and safety, and water quality regulation.

Environmental, health and safety, and water quality regulations are complex and change frequently, and they have tended to become more stringent over time. As newer or stricter standards are introduced, they could increase our operating expenses. We would generally expect to recover expenses associated with compliance for environmental and health and safety standards through rate increases, but this recovery may be affected by regulatory lag.

Economic Environment

The growth of our customer base depends almost entirely on the success of developers in developing residential and commercial properties within our service areas. Real estate development is a cyclical industry and development in our service areas is contingent upon construction or acquisition of major public improvements, such as arterial streets, drainage facilities, telephone and electrical facilities, recreational facilities, street lighting, and local in-tract improvements (e.g., site grading). Many of these improvements are built by municipalities with public financing, and municipal resources and access to capital may not be sufficient to support development in areas of rapid population growth.

Infrastructure Investment

Capital expenditures for infrastructure investment are a component of the rate base on which our regulated utility subsidiaries are allowed to earn an equity return. Capital expenditures for infrastructure provide a basis for earnings growth by expanding our “used and useful” rate base, which is a component of its permitted return on investment and revenue requirement. We are generally able to recover a rate of return on these capital expenditures (return on equity and debt), together with debt service and certain operating costs, through the rates we charge.

We have made significant capital investments in our territories within the last fourteen years, and because the infrastructure is new, we do not expect comparable capital investments to be required in the near term, either for growth or to maintain the existing infrastructure. Nevertheless, we have an established capital improvement plan to make targeted capital investments to repair and replace existing infrastructure as needed, address operating redundancy requirements, and improve our overall financial performance, by lowering expenses and increasing revenue. Additionally, to reduce our deferred tax liability of approximately \$19.4 million resulting from the gain on

the condemnation of the operations and assets of Valencia, we have substantially completed the planned investments within our capital improvement plan that we determined will qualify under the Internal Revenue Code §1033 re-investment criteria pursuant to a favorable Private Letter Ruling with the Internal Revenue Service. See “—Corporate Transactions—Private Letter Ruling” for additional information.

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Production and Treatment Costs

Our water and wastewater services require significant production resources and therefore result in significant production costs. Although we are permitted to recover these costs through the rates we charge, regulatory lag can decrease our margins and earnings if production costs or other operating expenses increase significantly before we are able to recover them through increased rates. Our most significant costs include labor, chemicals used to treat water and wastewater, and power used to operate pumps and other equipment. Power and chemical costs can be volatile. However, we employ a variety of technologies and methodologies to minimize costs and maximize operational efficiencies. Additionally, with our Total Water Management approach, whereby we maximize the direct beneficial reuse of recycled water, we can realize significant treatment costs and power savings because smaller volumes of water are required for potable use. Many utilities require that all water be treated to potable standards irrespective of use. Total Water Management focuses on the right water for the right use. Potable water is needed for consumption and recycled water is acceptable for non-potable uses such as irrigation and toilet flushing. Non-potable water does not need to be treated for commonly occurring and regulated constituents such as arsenic, or for other current or future human consumption health-based contaminants.

Weather and Seasonality

Our ability to meet the existing and future water demands of our customers depends on an adequate supply of water. Drought, overuse of sources of water, the protection of threatened species or habitats, or other factors may limit the availability of ground and surface water. Also, customer usage of water and recycled water is affected by weather conditions, particularly during the summer. Our water systems generally experience higher demand in the summer due to the warmer temperatures and increased usage by customers for irrigation and other outdoor uses. However, summer weather that is cooler or wetter than average generally suppresses customer water demand and can have a downward effect on our operating revenue and operating income. Conversely, when weather conditions are extremely dry, our business may be affected by government-issued drought-related warnings and/or water usage restrictions that would artificially lower customer demand and reduce our operating revenue. The limited geographic diversity of our service areas makes the results of our operations more sensitive to the effect of local weather extremes. The second and third quarters of the year are generally those in which revenues are highest. Accordingly, interim results should not be considered representative of the results of a full year.

Access to and Quality of Water Supply

In many areas of Arizona (including certain areas that we service), water supplies are limited and, in some cases, current usage rates exceed sustainable levels for certain water resources. We currently rely predominantly (and are likely to continue to rely) on the pumping of groundwater and the generation and delivery of recycled water for non-potable uses to meet future demands in our service areas. At present, groundwater (and recycled water derived from groundwater) is the primary water supply available to us. In addition, regulatory restrictions on the use of groundwater and the development of groundwater wells, lack of available water rights, drought, overuse of local or regional sources of water, protection of threatened species or habitats, or other factors, including climate change, may limit the availability of ground or surface water.

Rate Case Activity

On July 9, 2012, we filed rate applications with the ACC to adjust the revenue requirements for seven utilities. In August 2013, we entered into a settlement agreement with the ACC staff, the Residential Utility Consumers Office, the City of Maricopa, and other parties to the rate case. The settlement required approval by the ACC before it could take effect. In February 2014, the rate case proceedings were completed and the ACC issued Rate Decision No. 74364, approving the settlement agreement. The collective rate increase included a 9.5% return on common equity which contributed to a 15% increase over revenue in 2011.

For our utilities, adjusting for the condemnation of the operations and assets of Valencia and the sale of Willow Valley, the settlement provided for a collective aggregate revenue requirement increase of \$3.6 million based on 2011 test year service connections, phased-in over time, with the first increase in January 2015 as follows (in thousands):

| | Incremental | Cumulative |
|------|-------------|------------|
| 2015 | \$ 1,083 | \$ 1,083 |
| 2016 | 887 | 1,970 |
| 2017 | 335 | 2,305 |

| | |
|---------|-------|
| 2018335 | 2,640 |
| 2019335 | 2,975 |
| 2020335 | 3,310 |
| 2021335 | 3,645 |

Whereas this phase-in of additional revenues was determined using a 2011 test year, to the extent that the number of active service connections has increased and continues to increase from 2011 levels, the additional revenues may be greater than the amounts set forth above. On the other hand, if active connections decrease or we experience declining usage per customer, we may not realize all of the anticipated revenues.

From 2003 to 2008, we entered into approximately 183 infrastructure coordination and financing agreements (“ICFAs”) with developers and landowners covering approximately 275 square miles. Under these agreements, we have a contractual obligation to the developers and landowners to ensure that amongst other things, physical capacity exists through our regulated utilities for water and wastewater to the landowner/developer when needed. We receive fees from the landowner/developer for undertaking these obligations that typically are a negotiated amount per planned equivalent dwelling unit for the specified development or parcel of land. Payments are generally due to us from the landowner/developer based on progress of the development, with a portion due upon signing of the agreement, a portion due upon completion of certain milestones and the final payment due upon final plat approval or sale of the subdivision. The payments are non-refundable. Our investment can be considerable, as we may phase-in the construction of facilities in accordance with a regional master plan, as opposed to a single development.

Prior to January 1, 2010, we accounted for funds received under ICFAs as revenue once the obligations specified in the ICFA were met. As these arrangements are with developers and not with the end water or wastewater customer, the timing of revenue recognition coincided with the completion of our performance obligations under the agreement with the developer and with our ability to provide fitted capacity for water and wastewater service to the applicable development or parcel through our regulated subsidiaries.

The 2010 Regulatory Rate Decision No. 71878 established new rates for the recovery of reasonable costs incurred by the utilities and a return on invested capital. In determining the new annual revenue requirement, the ACC imputed a reduction to rate base for all amounts related to ICFA funds collected by us that the ACC deemed to be CIAC for rate making purposes. As a result of the decision by the ACC, we changed our accounting policy for the accounting of ICFA funds. Effective January 1, 2010, we recorded ICFA funds received as CIAC. Thereafter, the ICFA-related CIAC was amortized as a reduction of depreciation expense over the estimated depreciable life of the utility plant at the related utilities.

With the issuance of Rate Decision No. 74364, in February 2014, the ACC again changed how ICFA funds would be characterized and accounted for going forward. Most notably, the ACC changed the rate treatment of ICFA funds, and ICFA funds already received would no longer be deemed CIAC for rate making purposes. In conjunction with Rate Decision No. 74364, we eliminated the CIAC liability and reversed the associated regulatory liability brought about by the 2010 ruling. ICFA funds already received or which had become due prior to the date of Rate Decision No. 74364 were accounted for in accordance with our ICFA revenue recognition policy that had been in place prior to the 2010 Regulatory Rate Decision, wherein the funds received are recognized as revenue once the obligations specified in the ICFA were met. Rate Decision No. 74364 prescribes that of the ICFA funds which come due and are paid subsequent to December 31, 2013, 70% of the ICFA funds will be recorded in the associated utility subsidiary as a hook-up fee (“HUF”) liability, with the remaining 30% to be recorded as deferred revenue, until such time that the HUF tariff is fully funded, after which the remaining funds will be recorded as deferred revenue in accordance with our ICFA revenue recognition policy. A HUF tariff, specifying the dollar value of a HUF for each utility, was approved by the ACC as part of Rate Decision No. 74364. We are responsible for assuring the full HUF value is paid from ICFA proceeds, and recorded in its full amount by predetermined milestones in Rate Decision No. 74364, even if it results in recording more or less than 30% of the ICFA fee as deferred revenue.

We now account for the portion of future payments received under these agreements allocated to HUF liability as CIAC. However, from the regulator’s perspective, HUFs do not impact rate base until the related funds are expended. These funds are segregated in a separate bank account and used to construct plant assets. The HUF liability is to be relieved once the funds are used for the construction of plant. For facilities required under a hook-up fee or ICFA, we must first use the HUF funds received, after which we may use debt or equity financing for the remainder of construction. The deferred revenue portion of these fees is recognized as revenue once the obligations specified within the applicable ICFA are met, including construction of sufficient operating capacity to serve the customers for which revenue was deferred. We expect to recognize revenue during 2018 based on planned additional capacity to be added.

We have agreed not to enter into any new ICFAs, and instead will utilize HUF tariffs, which have become an acceptable industry practice in Arizona. As part of the settlement, a HUF tariff was established for each utility. Existing ICFAs will remain in place, with 70% of future ICFA payments to be recorded as HUFs until the HUF liability is fully funded. The HUF liability is relieved as funds are expended to construct plant, at which time a corresponding amount is recorded to CIAC. The portion of ICFA proceeds not recorded as HUF will be recorded as revenue or deferred revenue, in accordance with our ICFA revenue recognition policy.

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In addition to ICFAs, we have various line extension agreements with developers and builders, whereby funds, water line extensions or wastewater line extensions are provided to us by the developers and are considered refundable advances for construction. These AIACs are subject to refund by us to the developers through annual payments that are computed as a percentage of the total annual gross revenue earned from customers connected to utility services constructed under the agreement over a specified period. Upon the expiration of the agreements' refunding period, the remaining balance of the AIAC becomes nonrefundable and at that time is considered CIAC. CIAC are amortized as a reduction of depreciation expense over the estimated remaining life of the related utility plant. For rate-making purposes, a utility plant funded by AIAC and CIAC is excluded from rate base. The taxability of AIAC and CIAC was changed with the enactment of the TCJA. Previously, the majority of AIAC and CIAC that we collected were not taxable. However, with the enactment of the TCJA, they will be taxable going forward. The scope, timing and effect of the regulatory treatment of AIAC and CIAC under the TCJA are not known at this time.

Corporate Transactions

Stipulated Condemnation of the Operations and Assets of Valencia

On July 14, 2015, the Company closed the stipulated condemnation to transfer the operations and assets of Valencia to the City of Buckeye. Terms of the condemnation were agreed upon through a settlement agreement and stipulated final judgment of condemnation wherein the City of Buckeye acquired all the operations and assets of Valencia and assumed operation of the utility upon close. The City of Buckeye paid the Company \$55.0 million at close, plus an additional \$108,000 in working capital adjustments. The City of Buckeye is obligated to pay the Company a growth premium equal to \$3,000 for each new water meter installed within Valencia's prior service areas in the City of Buckeye, for a 20-year period ending December 31, 2034, subject to a maximum payout of \$45.0 million over the term of the agreement.

Sale of Loop 303 Contracts

In September 2013, we entered into an agreement to sell certain wastewater facilities main extension agreements and offsite water management agreements for the contemplated Loop 303 service area, along with their related rights and obligations (which we refer to collectively as the "Loop 303 Contracts"), relating to the 7,000-acre territory within a portion of the western planning area of the City of Glendale, Arizona known as the "Loop 303 Corridor." Pursuant to the agreement, we sold the Loop 303 Contracts to EPCOR for total proceeds of approximately \$4.1 million (\$3.1 million of which has been received as of December 31, 2017), which will be paid to us over a multi-year period. Receipt of the remaining proceeds will occur and be recorded as additional income over time as certain milestones are met between EPCOR and the developers/landowners of the Loop 303 Corridor. As part of the consideration, we agreed to complete certain engineering work required in the offsite water management agreements, which we completed in 2013, thereby satisfying our remaining obligations relating to the Loop 303 Contracts. In April 2015, we received proceeds of approximately \$296,000 related to the sale of the Loop 303 Contracts. As of March 31, 2018, proceeds of \$1.0 million remain outstanding, and when received will be recorded as additional income over time as certain milestones are met between EPCOR and the developers/landowners.

Private Letter Ruling

On June 2, 2016, the Company received a Private Letter Ruling from the Internal Revenue Service that, for purposes of deferring the approximately \$19.4 million gain realized from the condemnation of the operations and assets of Valencia, determined that the assets converted upon the condemnation of such assets could be replaced through certain reclamation facility improvements contemplated by the Company under Internal Revenue Code §1033 as property similar or related in service or use. In June 2016, the Company converted all operating subsidiaries from corporations to limited liability companies to take full advantage of the benefits of such ruling.

Pursuant to Internal Revenue Code §1033, the Company would have been able to defer the gain on condemnation through the end of 2017. On April 18, 2017, the Company filed a request for a one-year extension to defer the gain to the end of 2018, which the IRS approved on August 8, 2017. Following the approval of the extension, the Company has slightly modified the timing of certain planned investments within its capital improvement plan in accordance with Internal Revenue Code §1033. Accordingly, the Company substantially completed these investments in 2017, with the remaining improvements to be completed in the first half of 2018. As a result of the Private Letter Ruling, the Company increased capital expenditures in 2017 as compared to recent years, and expects corresponding reductions to occur in 2018, 2019, and beyond. As of March 31, 2018, our deferred tax liability relating to the condemnation was

approximately \$6.8 million. We plan to file another extension during 2018 which, if approved, will defer the gain to the end of 2019.

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Acquisition of Eagletail Water Company

On May 15, 2017, the Company acquired Eagletail Water Company ("Eagletail") for approximately \$80,000. At the time of acquisition, Eagletail, a small water utility located west of metropolitan Phoenix, added approximately 55 active water connections and eight square miles of approved service area to Global Water's existing regional service footprint.

Recent Events

ACC Tax Docket

On December 20, 2017, the ACC opened a docket to address the utility ratemaking implication of the Federal Tax Cuts and Jobs Act (the "TCJA"). Numerous companies, including GWRI's regulated utilities, filed comments on or before January 22, 2018. The ACC subsequently held a workshop regarding the tax issue on January 31, 2018, and then discussed and approved an order on February 6, 2018. The order requires all utilities in Arizona to "apply regulatory accounting treatment which, includes the use of regulatory assets and regulatory liabilities, to address all impacts from the enactment of the TCJA." The order also orders specified utilities on "Attachment A" to make one of the following three types of filings by April 7, 2018, "1) file an application for a tax expense adjustor mechanism, 2) file an intent to file a rate case within 90 days, or 3) any such other application to address rate making implications of the TCJA". All of our currently operating regulated utilities are listed on Attachment A (with the exception of Eagletail). We filed a proposal for a tax expense adjustor mechanism with the ACC on April 9, 2018. The proposal is in the process of being reviewed by the ACC and the ACC will issue an order approving, modifying, or rejecting the proposals. It is not clear what actions the ACC will ultimately take with regard to our regulated utilities. The ACC is considering the impact for regulated utilities, as it is expected that certain effects of the TCJA add to rate base and others reduce rate base. On May 1, 2018, the ACC Chairman filed a letter in the ACC's docket concerning the TCJA, stating that "it appears that there may be some unintended consequences related to the tax treatment of contributions in aid of construction ("CIAC") and advances in aid of construction ("AIAC")" and that "[i]t is my intent that the Commission wait to move forward on adversely affected water and wastewater companies until we find a balanced approach." At this point, it is not clear what action the ACC will take regarding the TCJA issues. As a result, we cannot determine the effect of the TCJA on currently enacted rates.

Line of Credit

On April 20, 2018, we entered into an agreement with MidFirst Bank, a federally chartered savings association, for a two-year revolving line of credit up to \$8.0 million. The credit facility, which will be used for acquisitions and general corporate purposes, will bear an interest rate of LIBOR plus 2.25%.

Definitive Agreement to Purchase Turner Ranches Water and Sanitation Company

On April 25, 2018, we signed a definitive agreement to acquire Turner Ranches Water and Sanitation Company ("Turner"), a non-potable irrigation water utility in Mesa, Arizona for the purchase price of \$2.8 million. Turner currently has 960 residential irrigation connections and approximately seven square miles of service area, including three golf courses. The acquisition is expected to close in the second quarter of 2018, subject to customary closing conditions and regulatory approval.

Segment Reporting

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing operating performance. In consideration of the Financial Accounting Standards Board's Accounting Standards Codification 280, Segment Reporting, we are not organized around specific products and services, geographic regions, or regulatory environments. We currently operate in one geographic region within the State of Arizona, wherein each operating utility operates within the same regulatory environment.

While we report revenue, disaggregated by service type, on the face of our statement of operations, we do not manage the business based on any performance measure at the individual revenue stream level. We do not have any customers that contribute more than 10% to our revenues or revenue streams. Additionally, the chief operating decision maker uses consolidated financial information to evaluate our performance, which is the same basis on which he communicates our results and performance to our board of directors. It is upon this consolidated basis from which he bases all significant decisions regarding the allocation of our resources on a consolidated level. Based on the information described above and in accordance with the applicable literature, management has concluded that we are

currently organized and operated as one operating and reportable segment.

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Comparison of Results of Operations for the Three Months Ended March 31, 2018 and 2017

The following table summarizes our results of operations for the three months ended March 31, 2018 and 2017 (in thousands, except per share amounts):

| | For the Three Months Ended March 31, | |
|----------------------------|--|---------|
| | 2018 | 2017 |
| Revenues | \$7,425 | \$6,791 |
| Operating expenses | 6,061 | 5,690 |
| Operating income | 1,364 | 1,101 |
| Total other expense | (903) | (742) |
| Income before income taxes | 461 | 359 |
| Income tax expense | (141) | (170) |
| Net income | \$320 | \$189 |

Basic earnings per common share \$0.02 \$0.01

Diluted earnings per common share \$0.02 \$0.01

Revenues – The following table summarizes our revenues for the three months ended March 31, 2018 and 2017 (in thousands):

| | For the Three Months Ended March 31, | |
|--|--|---------|
| | 2018 | 2017 |
| Water services | \$3,115 | \$2,785 |
| Wastewater and recycled water services | 4,297 | 3,988 |
| Unregulated revenues | 13 | 18 |
| Total revenues | \$7,425 | \$6,791 |

Total revenues increased \$634,000, or 9.3%, for the three months ended March 31, 2018 compared to the three months ended March 31, 2017. The increase in revenue reflects the 4.9% increase in active service connections combined with the increase in rates related to Rate Decision No. 74364 in February 2014 for the three months ended March 31, 2018 compared to the three months ended March 31, 2017.

Water Services – Water services revenue increased \$330,000, or 11.8%, to \$3.1 million for the three months ended March 31, 2018 compared to \$2.8 million for the three months ended March 31, 2017.

Water services revenue based on consumption increased by \$253,000, or 31.8%, to \$1.1 million for the three months ended March 31, 2018 compared to \$798,000 for the three months ended March 31, 2017. The increase in consumption revenue was primarily driven by an increase in rates related to Rate Decision No. 74364, coupled with increased consumption and connection growth for the three months ended March 31, 2018 compared to the three months ended March 31, 2017.

Active water connections increased 5.0% to 20,128 as of March 31, 2018 from 19,162 as of March 31, 2017, primarily due to the growth in our service areas.

Water consumption increased 16.5% to 411 million gallons for the three months ended March 31, 2018 from 352 million gallons for the three months ended March 31, 2017. The increase in consumption was primarily related to an increase in residential consumption.

Water services revenue, excluding miscellaneous charges associated with the basic service charge, increased \$103,000, or 5.6%, to \$2.0 million for the three months ended March 31, 2018 compared to \$1.8 million for the three months ended March 31, 2017. The increase resulted from an increase in active service connections, combined with an increase in rates related to Rate Decision No. 74364.

Wastewater and Recycled Water Services – Wastewater and recycled water services revenue increased \$309,000, or 7.7%, for the three months ended March 31, 2018 compared to the three months ended March 31, 2017. The increase in wastewater and recycled water services revenue was comprised of a \$256,000 increase in wastewater services revenue combined with a \$53,000 increase in recycled water services revenue for the three months ended March 31, 2018 compared to the three months ended March 31, 2017. The increase in wastewater services revenue reflects the increase in active wastewater connections, which increased 4.8% to 19,414 as of March 31, 2018 from 18,525 as of March 31, 2017, as well as the increase in rates related to Rate Decision No. 74364.

Recycled water services revenue, which is based on the number of gallons delivered, increased \$53,000, or 57.0%, to \$145,000 for the three months ended March 31, 2018 compared to \$92,000 for the three months ended March 31, 2017. The increase in recycled water services revenue was primarily related to the increase in recycled water consumption, coupled with an increase in recycled water rates related to Rate Decision No. 74364. The volume of recycled water delivered increased 34 million gallons, or 42.3%, to 113 million gallons for the three months ended March 31, 2018 compared to 80 million gallons for the three months ended March 31, 2017. Recycled water rates increased 10.3% per Rate Decision No. 74364 compared to 2017.

Operating Expenses – The following table summarizes our operating expenses for the three months ended March 31, 2018 and 2017 (in thousands):

| | For the Three Months Ended March 31, | |
|--|--|---------|
| | 2018 | 2017 |
| Operations and maintenance | \$1,509 | \$1,474 |
| Operations and maintenance - related party | 356 | 360 |
| General and administrative | 2,397 | 2,210 |
| Depreciation | 1,799 | 1,646 |
| Total operating expenses | \$6,061 | \$5,690 |

Operations and Maintenance – Operations and maintenance costs, consisting of personnel costs, production costs (primarily chemicals and purchased power), maintenance costs, and property tax, increased \$35,000, or 2.4%, for the three months ended March 31, 2018 compared to the three months ended March 31, 2017.

Property tax expense increased \$42,000, or 8.9%, to \$514,000 for the three months ended March 31, 2018 compared to \$472,000 for the three months ended March 31, 2017. Property taxes are calculated using a centrally valued property calculation, which derives property values based upon three-year historical average revenues. As revenues increase, we expect that property taxes will increase.

Total personnel expenses increased \$19,000, or 4.7%, to \$424,000 for the three months ended March 31, 2018 compared to \$405,000 for the three months ended March 31, 2017, primarily due to an increase in salaries and bonus partially offset by a decrease in medical insurance for the three months ended March 31, 2018 compared to the three months ended March 31, 2017.

Repairs and maintenance expense decreased \$28,000, or 40.6%, to \$41,000 for the three months ended March 31, 2018 compared to \$69,000 for the three months ended March 31, 2017. The decrease in repair and maintenance expense was primarily attributed to work performed as part of the accelerated capital expenditure plan. Refer to "— Corporate Transactions — Private Letter Ruling" for additional information. The addition of assets added through the plan has reduced the repair and maintenance requirements.

General and Administrative – General and administrative costs include the day-to-day expenses of office operation, personnel costs, legal and other professional fees, insurance, rent, and regulatory fees. These costs increased \$187,000, or 8.5%, during the three months ended March 31, 2018 compared to the three months ended March 31, 2017.

Personnel and related expenses increased \$243,000, or 34.0%, to \$958,000 for the three months ended March 31, 2018, compared to \$715,000 for the three months ended March 31, 2017. The increase was primarily related to increases in salaries and bonus, coupled with a one-time severance payment, for the three months ended March 31, 2018 compared to the three months ended March 31, 2017.

Professional fees increased \$170,000, or 35.7%, to \$646,000 for the three months ended March 31, 2018, compared to \$476,000 for the three months ended March 31, 2017. The increase was primarily related to expenses associated with contemplated acquisition targets and the TCJA analysis performed during the three months ended March 31, 2018.

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Deferred compensation expense decreased \$210,000, or 119.3%, to income of \$34,000 for the three months ended March 31, 2018, compared to an expense of \$176,000 for the three months ended March 31, 2017. The decrease was primarily related to a forfeiture of stock appreciation rights, slightly offset by the increase in expense related to a 2017 stock option grant.

Regulatory expense decreased \$36,000, or 73.5%, to \$13,000 for the three months ended March 31, 2018, compared to \$49,000 for the three months ended March 31, 2017, primarily due to the full amortization of the rate case expenses ending in 2017.

Depreciation – Depreciation expense increased \$153,000, or 9.3%, to \$1.8 million for the three months ended March 31, 2018 compared to \$1.6 million for the three months ended March 31, 2017. The increase in depreciation expense was primarily due to an increase in fixed assets associated with the accelerated capital expenditure plan relating to the previously discussed Private Letter Ruling.

Other Income (Expense) – Other expense totaled \$903,000 for the three months ended March 31, 2018 compared to other expense of \$742,000 for the three months ended March 31, 2017. The increase of \$161,000 in other expense was primarily attributed to a \$216,000 change in Other – related party income (expense) coupled with a decrease in the Valencia earnout of \$72,000. These income reductions were partially offset by a decrease in interest expense of \$80,000. Additionally, we recognized \$41,000 in gain of disposal of assets for the three months ended March 31, 2018, compared to a loss on disposal of assets of \$4,000 for the three months ended March 31, 2017. The Valencia earnout consists of \$3,000 for each new water meter installed within Valencia Water Company’s prior service areas. This decrease was primarily driven by slowed growth in our former service territory.

Other – related party income (expense) changed \$216,000 to an expense of \$2,000 for the three months ended March 31, 2018 compared to income of \$214,000 for the three months ended March 31, 2017. Other related party income (expense) includes royalty income based upon a percentage of certain FATHOM™ recurring revenue combined with the equity method gains and losses associated with our equity method investment in FATHOM™. The change in other related party income (expense) was primarily driven by the equity method loss recorded on our investment in FATHOM™ of \$110,000 for the three months ended March 31, 2018 compared to income of \$122,000 for the three months ended March 31, 2017. See Note 5 – “Equity Method Investment” to the condensed consolidated financial statement in Part I, Item 1 of this report for additional information.

Income Tax Expense – Income tax expense decreased \$29,000 to \$141,000 for the three months ended March 31, 2018 compared to \$170,000 for the three months ended March 31, 2017. The decrease was driven by a decrease in the corporate tax rate, partially offset by an increase in pretax income for the three months ended March 31, 2018 compared to the three months ended March 31, 2017.

Net Income – Net income totaled \$320,000 for the three months ended March 31, 2018 compared to net income of \$189,000 for the three months ended March 31, 2017. The \$131,000 increase was primarily attributed to the \$263,000 increase in operating income, partially offset by the \$161,000 increase in other expense for the three months ended March 31, 2018 compared to the three months ended March 31, 2017.

Outstanding Share Data

As of May 7, 2018, there were 19,631,266 shares of our common stock outstanding and options to acquire an additional 684,400 shares of our common stock outstanding.

Liquidity and Capital Resources

Our capital resources are provided by internally generated cash flows from operations as well as debt and equity financing. Additionally, our regulated utility subsidiaries receive advances and contributions from customers, home builders, and real estate developers to partially fund construction necessary to extend service to new areas. We use our capital resources to:

- fund operating costs;
- fund capital requirements, including construction expenditures;
- pay dividends;
- fund acquisitions;
- make debt and interest payments; and

invest in new and existing ventures.

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Our utility subsidiaries operate in rate-regulated environments in which the amount of new investment recovery may be limited. Such recovery will take place over an extended period of time because recovery through rate increases is subject to regulatory lag.

As of March 31, 2018, we have no notable near-term cash expenditures or debt obligations. While specific facts and circumstances could change, we believe that we have sufficient cash on hand and will be able to generate sufficient cash flows to meet our operating cash flow requirements and capital expenditure plan as well as remain in compliance with our debt covenants for at least the next twelve months.

In March 2014, we initiated a dividend program to declare and pay a monthly dividend. On November 9, 2017, we announced a monthly dividend increase from \$0.02306 per share (\$0.27672 per share annually) to \$0.023625 per share (\$0.2835 per share annually). Although we expect monthly dividends will be declared and paid for the foreseeable future, the declaration of any dividends is at the discretion of our board of directors and is subject to legal requirements and debt service ratio covenant requirements (refer to “—Senior Secured Notes”).

Cash from Operating Activities

Cash flows provided by operating activities are used for operating needs and to meet capital expenditure requirements. Our future cash flows from operating activities will be affected by economic utility regulation, infrastructure investment, growth in service connections, customer usage of water, compliance with environmental health and safety standards, production costs, weather, and seasonality.

For the three months ended March 31, 2018, our net cash provided by operating activities totaled \$4.0 million compared to \$2.1 million for the three months ended March 31, 2017. The \$1.9 million change in cash from operating activities was primarily driven by the decrease in payments related to accounts payable for the three months ended March 31, 2018 compared to the three months ended March 31, 2017, primarily property taxes.

Cash Used In Investing Activities

Our net cash used in investing activities totaled \$1.1 million for the three months ended March 31, 2018 compared to \$6.5 million for the three months ended March 31, 2017. The \$5.4 million change in cash used in investing activities was primarily driven by a decrease in capital expenditures of \$5.4 million for the three months ended March 31, 2018 compared to the three months ended March 31, 2017.

We continue to invest capital prudently in our existing, core service areas where we are able to deploy our Total Water Management model as service connections grow. This includes any required maintenance capital expenditures and the construction of new water and wastewater treatment and delivery facilities. Capital expenditures increased in 2017 as compared to recent years as a result of our decision to accelerate certain capital expenditures within our capital improvement plan related to the Private Letter Ruling (refer to “—Corporate Transactions—Private Letter Ruling”). Our projected capital expenditures and other investments are subject to periodic review and revision to reflect changes in economic conditions and other factors.

Cash Used In Financing Activities

Our net cash used in financing activities totaled \$1.2 million for the three months ended March 31, 2018, a \$0.1 million change as compared to the \$1.3 million in cash used in financing activities for the three months ended March 31, 2017. This change was primarily driven by an increase in AIAC receipts coupled with a decrease in principal payments made under capital leases, partially offset by an increase in dividends paid for the three months ended March 31, 2018, compared to the three months ended March 31, 2017.

Senior Secured Notes

On June 24, 2016, we issued two series of senior secured notes with a total principal balance of \$115.0 million at a blended interest rate of 4.55%. Series A carries a principal balance of \$28.8 million and bears an interest rate of 4.38% over a twelve-year term, with the principal payment due on June 15, 2028. Series B carries a principal balance of \$86.3 million and bears an interest rate of 4.58% over a 20-year term. Series B is interest only for the first five years, with \$1.9 million principal payments paid semiannually thereafter. The proceeds of the senior secured notes were primarily used to refinance the previously held long-term tax exempt bonds, pursuant to an early redemption option at 103%, plus accrued interest, as a result of the initial public offering of our common stock in May 2016.

The senior secured notes require the Company to maintain a debt service coverage ratio of consolidated EBITDA to consolidated debt service of at least 1.10 to 1.00. Consolidated EBITDA is calculated as net income plus depreciation, taxes, interest and other non-cash charges net of non-cash income. Consolidated debt service is calculated as interest expense, principal payments, and dividend or stock repurchases. The senior secured notes also contain a provision limiting the payment of dividends if the Company falls below a debt service ratio of 1.25. However, for the quarter ending June 30, 2021 through the quarter ending March 31, 2024, the ratio drops to 1.20. As of March 31, 2018, the Company was in compliance with its financial debt covenants.

Line of Credit

On April 20, 2018, the Company entered into a loan agreement ("Loan Agreement") with MidFirst Bank, a federally chartered savings association, on the terms and subject to conditions set forth in the Loan Agreement, for a revolving credit facility in the maximum principal amount of \$8.0 million. The Company intends to use the proceeds for future acquisitions and general corporate purposes.

Borrowings under the Loan Agreement will bear interest at a rate equal to the London Interbank Offered Rate ("LIBOR") plus 2.25%. The scheduled maturity date is April 30, 2020, subject to certain prepayment requirements upon change of control.

The Loan Agreement contains a debt service coverage ratio financial maintenance covenant and contains certain restrictive covenants that limit, among other things, the Company's ability to: create liens and other encumbrances; incur additional indebtedness; merge, liquidate or consolidate with another entity; dispose of or transfer assets; make distributions or other restricted payments; engage in certain affiliate transactions; and change the nature of the business. The foregoing covenants are subject to various qualifications and limitations as set forth in the Loan Agreement. Pursuant to the Loan Agreement, the revolving credit facility will be subject to certain customary events of default after which the revolving credit facility may be declared due and payable if not cured within the grace period or, in certain circumstances, may be declared due and payable immediately.

Insurance Coverage

We carry various property, casualty, and financial insurance policies with limits, deductibles, and exclusions consistent with industry standards. However, insurance coverage may not be adequate or available to cover unanticipated losses or claims. We are self-insured to the extent that losses are within the policy deductible or exceed the amount of insurance maintained. Such losses could have a material adverse effect on our short-term and long-term financial condition and the results of operations and cash flows.

Critical Accounting Policies, Judgments, and Estimates

The application of critical accounting policies is particularly important to our financial condition and results of operations and provides a framework for management to make significant estimates, assumptions, and other judgments. Additionally, our financial condition, results of operations, and cash flow are impacted by the methods, assumptions, and estimates used in the application of critical accounting policies. Although our management believes that these estimates, assumptions, and other judgments are appropriate, they relate to matters that are inherently uncertain and that may change in subsequent periods. Accordingly, changes in the estimates, assumptions, and other judgments applied to these accounting policies could have a significant impact on our financial condition and results of operations as reflected in our financial statements.

There have been no significant changes to our critical accounting policies from those disclosed under "Managements' Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies, Judgments, and Estimates" in our most recent Annual Report on Form 10-K filed with the SEC on March 9, 2018.

Off Balance Sheet Arrangements

As of March 31, 2018 and December 31, 2017, we did not have any off-balance sheet arrangements.

Contractual Obligations

The following table summarizes our contractual cash obligations as of March 31, 2018 (in thousands):

| | Total | Payments Due By Period | | | |
|---|-----------|------------------------|-------------|-------------|-------------------|
| | | Less than 1 Year | 1 - 3 Years | 3 - 5 Years | More than 5 Years |
| Long term debt obligations | \$115,064 | \$8 | \$18 | \$5,757 | \$109,281 |
| Interest on long-term debt ⁽²⁾ | 67,218 | 5,212 | 10,423 | 10,288 | 41,295 |
| Capital lease obligations | 93 | 21 | 47 | 25 | — |
| Interest on capital lease | 14 | 6 | 7 | 1 | — |
| Operating lease obligations | 164 | 116 | 43 | 5 | — |
| FATHOM™ purchase obligations ⁽³⁾ | 717 | 717 | — | — | — |
| Total ⁽¹⁾ | \$183,270 | \$6,080 | \$10,538 | \$16,076 | \$150,576 |

In addition to these obligations, the Company pays annual refunds on AIAC over a specific period of time based on operating revenues generated from developer-installed infrastructure. The refund amounts are considered an investment in infrastructure and eligible for inclusion in future rate base. These refund amounts are not included in (1) the above table because the refund amounts and timing are dependent upon several variables, including new customer connections, customer consumption levels, and future rate increases, which cannot be accurately estimated. Portions of these refund amounts are payable annually over the next two decades, and amounts not paid by the contract expiration dates become nonrefundable and are transferred to contributions in aid of construction.

(2) Interest on the long-term debt is based on the fixed rates of the Company's senior secured notes.

The Company entered into an agreement with FATHOM™ to replace a majority of its meter infrastructure in 2017.

(3) This project was completed in 2017. The final amount to be paid is subject to finalizing contractual terms of the agreement. Refer to Note 7 – “Transactions with Related Parties” of the Notes to the Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q for additional information.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk associated with changes in commodity prices, equity prices, and interest rates. The Company uses fixed-rate long-term debt to reduce the risk from interest rate fluctuations. Although the Company's long-term debt is based on fixed rates, changes in interest rates could impact the fair market value of the Company's long-term debt. As of March 31, 2018, the fair market value of the Company's long-term debt was \$112.5 million. For additional information about the Company's long-term debt, see Note 9 – “Debt” of the Notes to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q.

Other than interest-related risks, the Company believes the risks associated with price increases for chemicals, electricity, and other commodities are mitigated by the Company's ability over the long-term to recover its costs through rate increases to its customers, though such recovery is subject to regulatory lag.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Office and Chief Financial Officer, reviewed and evaluated our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Office and Chief Financial Officer have concluded that our disclosure controls and procedures are effective in providing them with timely material information relating to the Company.

Change in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during the fiscal quarter ended March 31, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the ordinary course of business, we may, from time to time, be subject to various pending and threatened lawsuits in which claims for monetary damages are asserted. To our knowledge, we are not involved in any legal proceeding which is expected to have a material effect on us.

ITEM 1A. RISK FACTORS

There have been no material changes in our risk factors from those disclosed in "Risk Factors" included in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

a) Sales of Unregistered Securities

No unregistered securities were sold during the three months ended March 31, 2018.

b) Use of Proceeds

None.

c) Issuer Purchases of Equity Securities

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

| Exhibit Number | Description of Exhibit | Method of Filing |
|----------------|--|---|
| 2.1.1 | <u>Arrangement Agreement</u> | Incorporated by reference to Exhibit 2.1 of the Company's Registration Statement on Form S-1 (File No. 333-209025) filed January 19, 2016. |
| 2.1.2 | <u>Plan of Arrangement</u> | Incorporated by reference to Exhibit 2.1.2 of Amendment No. 2 to the Company's Registration Statement on Form S-1 (File No. 333-209025) filed April 13, 2016. |
| 3.1 | <u>Second Amended and Restated Certificate of Incorporation of Global Water Resources, Inc.</u> | Incorporated by reference to Exhibit 3.1 of the Company's Form 8-K filed May 4, 2016. |
| 3.2 | <u>Amended and Restated Bylaws of Global Water Resources, Inc.</u> | Incorporated by reference to Exhibit 3.2 of the Company's Form 8-K filed May 4, 2016. |
| 10.1 | <u>Full Waiver and Release of all Claims, dated as of February 20, 2018, by and between Global Water Resources, Inc. and Jeffrey Risenmay*</u> | Filed herewith. |
| 10.2 | <u>Independent Contractor Agreement, dated as of February 20, 2018, by and between Global Water Resources, Inc. and Jeffrey Risenmay*</u> | Filed herewith (included as Exhibit 1 in Exhibit 10.1). |
| 10.3 | <u>Fourth Amendment to Global Water Resources, Inc. Deferred Phantom Stock Unit Plan*</u> | Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on March 13, 2018. |
| 10.4 | <u>Third Amendment to Global Water Resources, Inc. Stock Option Plan*</u> | Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on March 13, 2018. |
| 10.5 | <u>Loan Agreement, dated April 20, 2018, by and between Global Water Resources, Inc. and MidFirst Bank</u> | Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on April 25, 2018. |
| 10.6 | <u>Guaranty Agreement, dated as of April 20, 2018, by Global Water, LLC</u> | Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on April 25, 2018. |
| 10.7 | <u>Guaranty Agreement, dated as of April 20, 2018, by West Maricopa Combine, LLC</u> | Incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the SEC on April 25, 2018. |

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- 10.8 Pledge and Security Agreement, dated as of April 20, 2018, by and between Global Water Resources, Inc. and U.S. Bank National Association, as collateral agent Incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed with the SEC on April 25, 2018.
- 10.9 Pledge and Security Agreement, dated as of April 20, 2018, by and between Global Water, LLC and U.S. Bank National Association, as collateral agent Incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed with the SEC on April 25, 2018.
- 10.10 Pledge and Security Agreement, dated as of April 20, 2018, by and between West Maricopa Combine, LLC and U.S. Bank National Association, as collateral agent Incorporated by reference to Exhibit 10.6 to the Company's Current Report on Form 8-K filed with the SEC on April 25, 2018.

| | | |
|---------|--|---|
| 10.11 | <u>Amendment No. 2 to Note Purchase Agreement dated May 20, 2016 and Amendment No. 1 to Security Agreements dated as of June 24, 2016, dated April 18, 2018, by and among Global Water Resources, Inc., Global Water, LLC, West Maricopa Combine, LLC, U.S. Bank, National Association, as collateral agent, and the noteholders party thereto</u> | Incorporated by reference to Exhibit 10.7 to the Company's Current Report on Form 8-K filed with the SEC on April 25, 2018. |
| 31.1 | <u>Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer</u> | Filed herewith. |
| 31.2 | <u>Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer</u> | Filed herewith. |
| 32.1 | <u>Section 1350 Certification of Chief Executive Officer and Chief Financial Officer</u> | Furnished herewith. |
| 101.INS | XBRL Instance Document | Filed herewith. |
| 101.SCH | XBRL Taxonomy Extension Schema Document | Filed herewith. |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | Filed herewith. |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | Filed herewith. |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | Filed herewith. |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | Filed herewith. |

*Management contract or compensatory plan or arrangement.

SIGNATURES

Pursuant to the requirements 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.

Global Water Resources, Inc.

Date: May 9, 2018 By: /s/ Michael J. Liebman

Michael J. Liebman

Chief Financial Officer and Corporate Secretary

(Duly Authorized Officer and Principal Financial Officer)