

**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 September 30, 2020

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

90-0632193

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

21410 N. 19th Avenue #220

Phoenix, Arizona

85027

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (480) 360-7775  
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, par value \$0.01 per share	GWRS	The NASDAQ Stock Market, LLC

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 every Interactive Data File required to be submitted 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 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	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input checked="" type="checkbox"/>

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 November 2, 2020, the registrant had 22,586,726 shares of common stock, \$0.01 par value per share, outstanding.

**TABLE OF CONTENTS**

<b>PART I.</b>	<b><u><a href="#">FINANCIAL INFORMATION</a></u></b>	
Item 1.	<u><a href="#">Financial Statements (Unaudited)</a></u>	<u><a href="#">3</a></u>
	<u><a href="#">Condensed Consolidated Balance Sheets</a></u>	<u><a href="#">3</a></u>
	<u><a href="#">Condensed Consolidated Statements of Operations</a></u>	<u><a href="#">4</a></u>
	<u><a href="#">Condensed Consolidated Statements of Shareholders' Equity</a></u>	<u><a href="#">5</a></u>
	<u><a href="#">Condensed Consolidated Statements of Cash Flows</a></u>	<u><a href="#">6</a></u>
	<u><a href="#">Notes to Unaudited Condensed Consolidated Financial Statements</a></u>	<u><a href="#">8</a></u>
Item 2.	<u><a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a></u>	<u><a href="#">27</a></u>
Item 3.	<u><a href="#">Quantitative and Qualitative Disclosures About Market Risk</a></u>	<u><a href="#">43</a></u>
Item 4.	<u><a href="#">Controls and Procedures</a></u>	<u><a href="#">44</a></u>
<b>PART II.</b>	<b><u><a href="#">OTHER INFORMATION</a></u></b>	
Item 1.	<u><a href="#">Legal Proceedings</a></u>	<u><a href="#">45</a></u>
Item 1A.	<u><a href="#">Risk Factors</a></u>	<u><a href="#">45</a></u>
Item 2.	<u><a href="#">Unregistered Sales of Equity Securities and Use of Proceeds</a></u>	<u><a href="#">46</a></u>
Item 3.	<u><a href="#">Defaults Upon Senior Securities</a></u>	<u><a href="#">46</a></u>
Item 4.	<u><a href="#">Mine Safety Disclosures</a></u>	<u><a href="#">46</a></u>
Item 5.	<u><a href="#">Other Information</a></u>	<u><a href="#">46</a></u>
Item 6.	<u><a href="#">Exhibits</a></u>	<u><a href="#">47</a></u>
	<u><a href="#">Signatures</a></u>	<u><a href="#">48</a></u>

**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)

	September 30, 2020	December 31, 2019
<b>ASSETS</b>		
PROPERTY, PLANT AND EQUIPMENT:		
Property, plant and equipment	334,769	326,303
Less accumulated depreciation	(98,351)	(92,749)
Net property, plant and equipment	<u>236,418</u>	<u>233,554</u>
CURRENT ASSETS:		
Cash and cash equivalents	18,062	7,513
Accounts receivable — net	2,146	1,631
Customer payments in-transit	286	—
Due from affiliates	—	426
Unbilled revenue	2,581	2,048
Prepaid expenses and other current assets	1,029	675
Total current assets	<u>24,104</u>	<u>12,293</u>
OTHER ASSETS:		
Goodwill	4,398	4,398
Intangible assets — net	11,726	12,554
Regulatory asset	1,970	1,715
Restricted cash	2,315	1,582
Other noncurrent assets	9	17
Total other assets	<u>20,418</u>	<u>20,266</u>
<b>TOTAL ASSETS</b>	<u><b>280,940</b></u>	<u><b>266,113</b></u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
CURRENT LIABILITIES:		
Accounts payable	195	992
Accrued expenses	8,615	7,546
Deferred revenue	10	—
Customer and meter deposits	1,513	1,445
Long-term debt and capital leases — current portion	118	117
Total current liabilities	<u>10,451</u>	<u>10,100</u>
NONCURRENT LIABILITIES:		
Long-term debt and capital leases	114,594	114,664
Deferred revenue - ICFA	17,446	17,372
Regulatory liability	8,331	8,803
Advances in aid of construction	72,077	67,621
Contributions in aid of construction — net	14,580	14,520
Deferred income tax liabilities — net	5,214	4,919
Acquisition liability	1,773	1,773
Other noncurrent liabilities	2,657	1,669
Total noncurrent liabilities	<u>236,672</u>	<u>231,341</u>
Total liabilities	<u>247,123</u>	<u>241,441</u>
Commitments and contingencies (Refer to Note 16)		
SHAREHOLDERS' EQUITY:		
Common stock, \$0.01 par value, 60,000,000 shares authorized; 22,686,708 and 21,636,420 shares issued as of September 30, 2020 and December 31, 2019, respectively.	227	216
Treasury stock, 99,982 and 99,039 shares at September 30, 2020 and December 31, 2019, respectively.	(1)	(1)
Paid in capital	33,591	24,457
Retained earnings	—	—
Total shareholders' equity	<u>33,817</u>	<u>24,672</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u><b>280,940</b></u>	<u><b>266,113</b></u>

See accompanying notes to the condensed consolidated financial statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
<b>REVENUES:</b>				
Water services	\$ 5,492	\$ 4,963	\$ 13,555	\$ 12,344
Wastewater and recycled water services	5,238	4,962	15,187	14,393
Unregulated revenues	27	17	134	49
Total revenues	<u>10,757</u>	<u>9,942</u>	<u>28,876</u>	<u>26,786</u>
<b>OPERATING EXPENSES:</b>				
Operations and maintenance	2,584	1,914	7,156	5,417
Operations and maintenance - related party	—	435	—	1,287
General and administrative	2,969	3,074	8,682	8,099
Depreciation and amortization	2,312	1,957	6,622	5,977
Total operating expenses	<u>7,865</u>	<u>7,380</u>	<u>22,460</u>	<u>20,780</u>
OPERATING INCOME	<u>2,892</u>	<u>2,562</u>	<u>6,416</u>	<u>6,006</u>
<b>OTHER INCOME (EXPENSE):</b>				
Interest income	9	49	88	167
Interest expense	(1,342)	(1,341)	(4,039)	(4,044)
Other	70	68	(361)	1,218
Other - related party	—	97	—	213
Total other expense	<u>(1,263)</u>	<u>(1,127)</u>	<u>(4,312)</u>	<u>(2,446)</u>
INCOME BEFORE INCOME TAXES	1,629	1,435	2,104	3,560
INCOME TAX EXPENSE	(498)	(388)	(741)	(1,086)
NET INCOME	<u>\$ 1,131</u>	<u>\$ 1,047</u>	<u>\$ 1,363</u>	<u>\$ 2,474</u>
Basic earnings per common share	\$ 0.05	\$ 0.05	\$ 0.06	\$ 0.12
Diluted earnings per common share	\$ 0.05	\$ 0.05	\$ 0.06	\$ 0.11
Dividends declared per common share	\$ 0.07	\$ 0.07	\$ 0.22	\$ 0.21
Weighted average number of common shares used in the determination of:				
Basic	22,586,588	21,536,834	22,495,675	21,509,770
Diluted	22,633,133	21,571,240	22,530,371	21,521,255

See accompanying notes to the condensed consolidated financial statements

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

	Common Stock Shares	Common Stock	Treasury Stock Shares	Treasury Stock	Paid-in Capital	Retained Earnings	Total Equity
BALANCE - December 31, 2018	21,530,470	\$ 215	(59,174)	\$ (1)	\$ 27,657	\$ —	\$ 27,871
Dividend declared \$0.07 per share	—	—	—	—	(888)	(649)	(1,537)
Stock compensation	—	—	—	—	65	—	65
Net income	—	—	—	—	—	649	649
BALANCE - March 31, 2019	21,530,470	\$ 215	(59,174)	\$ (1)	\$ 26,834	\$ —	\$ 27,048
Dividend declared \$0.07 per share	—	—	—	—	(764)	(778)	(1,542)
Treasury stock	—	—	(38,462)	—	—	—	—
Stock option exercise	104,000	1	—	—	412	—	413
Stock compensation	—	—	—	—	66	—	66
Net income	—	—	—	—	—	778	778
BALANCE - June 30, 2019	21,634,470	\$ 216	(97,636)	\$ (1)	\$ 26,548	\$ —	\$ 26,763
Dividend declared \$0.07 per share	—	—	—	—	(494)	(1,047)	(1,541)
Stock compensation	—	—	—	—	93	—	93
Net income	—	—	—	—	—	1,047	1,047
September 30, 2019	21,634,470	\$ 216	(97,636)	\$ (1)	\$ 26,147	\$ —	\$ 26,362
BALANCE - December 31, 2019	21,636,420	\$ 216	(99,039)	\$ (1)	\$ 24,457	\$ —	\$ 24,672
Dividend declared \$0.07 per share	—	—	—	—	(1,274)	(354)	(1,628)
Issuance of common stock	1,000,000	10	—	—	11,511	—	11,521
Stock compensation	—	—	—	—	115	—	115
Net income	—	—	—	—	—	354	354
BALANCE - March 31, 2020	22,636,420	\$ 226	(99,039)	\$ (1)	\$ 34,809	\$ —	\$ 35,034
Dividend declared \$0.07 per share	—	—	—	—	(1,633)	—	(1,633)
Issuance of common stock	49,163	1	—	—	(3)	—	(2)
Stock compensation	—	—	—	—	768	—	768
Net income	—	—	—	—	—	(122)	(122)
BALANCE - June 30, 2020	22,685,583	\$ 227	(99,039)	\$ (1)	\$ 33,941	\$ (122)	\$ 34,045
Dividend declared \$0.07 per share	—	—	—	—	(624)	(1,009)	\$ (1,633)
Treasury stock	—	—	(943)	—	(1)	—	(1)
Stock option exercise	1,125	—	—	—	—	—	—
Stock compensation	—	—	—	—	275	—	275
Net income	—	—	—	—	—	1,131	1,131
BALANCE - September 30, 2020	22,686,708	\$ 227	(99,982)	\$ (1)	\$ 33,591	\$ —	\$ 33,817

See accompanying notes to the condensed consolidated financial statements

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

	Nine Months Ended September 30,	
	2020	2019
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 1,363	\$ 2,474
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred compensation	1,708	1,412
Depreciation and amortization	6,622	5,977
Amortization of deferred debt issuance costs and discounts	103	73
Loss on equity investment	—	79
Other (gains) and losses	551	(1)
Provision for doubtful accounts receivable	100	34
Deferred income tax expense	295	660
Changes in assets and liabilities		
Accounts receivable	(615)	(326)
Other current assets	(749)	(341)
Accounts payable and other current liabilities	1,095	245
Other noncurrent assets	(255)	56
Other noncurrent liabilities	1,479	835
Net cash provided by operating activities	<u>11,697</u>	<u>11,177</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(7,490)	(7,785)
Other cash flows from investing activities	(9)	3
Net cash used in investing activities	<u>(7,499)</u>	<u>(7,782)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Dividends paid	(4,896)	(4,620)
Advances in aid of construction	1,575	743
Proceeds from stock option exercise	—	413
Principal payments under capital lease	(77)	(40)
Refunds of advances for construction	(959)	(903)
Loan borrowings	—	31
Loan repayments	(24)	(39)
Proceeds from sale of stock	11,739	—
Debt issuance costs paid	(53)	(40)
Payments of offering costs for sale of stock	(221)	—
Net cash (used) provided by financing activities	<u>7,084</u>	<u>(4,455)</u>
INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH	11,282	(1,060)
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH — Beginning of period	9,095	13,197
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH — End of period	<u>\$ 20,377</u>	<u>\$ 12,137</u>

See accompanying notes to the condensed consolidated financial statements

**Supplemental disclosure of cash flow information:**

	<u>September 30, 2020</u>	<u>September 30, 2019</u>
Cash and cash equivalents	\$ 18,062	\$ 11,091
Restricted Cash	2,315	1,046
Total cash, cash equivalents, and restricted cash	<u>\$ 20,377</u>	<u>\$ 12,137</u>

**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 September 30, 2020 and for the three and nine months ended September 30, 2020 and 2019 are unaudited. The December 31, 2019 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, 2019. 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 and nine months ended September 30, 2020 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 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. The Company received the final \$1.0 million of proceeds in March 2019 and recorded the amount in other income.

*Stipulated Condemnation of the Operations and Assets of Valencia Water Company, Inc.*

On July 14, 2015, the Company closed the stipulated condemnation to transfer the operations and assets of Valencia Water Company, Inc. (“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 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. The Company received growth premiums of \$0.1 million for both the three months ended September 30, 2020 and 2019, and \$0.2 million for both the nine months ended September 30, 2020 and 2019.

*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, 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.

Pursuant to Internal Revenue Code §1033, the Company would have been able to defer the gain on condemnation through the end of 2017, which was subsequently extended through the end of 2020. The Company fully deferred the remaining tax liability during the nine months ended September 30, 2020.

*Acquisition of Red Rock Utilities*

On October 16, 2018, the Company completed the acquisition of Red Rock Utilities ("Red Rock"), an operator of a water and a wastewater utility with service areas in the Pima and Pinal counties of Arizona, for a purchase price of \$5.9 million. The acquisition added over 1,650 connections and approximately 9 square miles of service area. The Company is obligated to pay to the seller a growth premium equal to \$750 for each new account established within three specified growth premium areas, commencing in each area on the date of the first meter installation and ending on the earlier of ten years after such first installation date or twenty years from the acquisition date. The three specified growth premium areas are located in Pima County, Arizona where Red Rock has not yet begun operating, and where Red Rock is authorized to provide water utility services only. As of September 30, 2020, no meters have been installed and no accounts have been established in any of the three growth premium areas. Refer to Note 7 — "Acquisitions" of the notes to the unaudited condensed consolidated financial statements for additional information regarding the Red Rock acquisition.

*Arizona Corporation Commission (the "ACC") Tax Docket*

The Company had regulatory assets of \$2.0 million and \$1.7 million at September 30, 2020 and December 31, 2019, respectively, and regulatory liabilities of \$0.7 million and \$0.6 million at September 30, 2020 and December 31, 2019, respectively, related to the Federal Tax Cuts and Jobs Act (the "TCJA") signed into law on December 22, 2017. Under ASC 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.

On December 20, 2017, the ACC opened a docket to address the utility ratemaking implications of the TCJA. The ACC subsequently approved an order in February 2018 requiring Arizona utilities 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.

On September 20, 2018, the ACC issued Rate Decision No. 76901, which set forth the reductions in revenue for our Santa Cruz, Palo Verde, Greater Tonopah and Northern Scottsdale utilities due to the lower corporate tax rates under the TCJA. Rate Decision No. 76901 adopted a phase-in approach for the reductions to match the phase-in of our revenue requirement under Rate Decision No. 74364 enacted in February 2014. In 2019, the aggregate annual reductions in revenue for our Santa Cruz, Palo Verde, Greater Tonopah, and Northern Scottsdale utilities was approximately \$0.9 million. In 2021, the final year of the phase-in, the aggregate annual reductions in revenue for our Santa Cruz, Palo Verde, Greater Tonopah, and Northern Scottsdale utilities will be approximately \$1.1 million. The ACC also approved a carrying cost of 4.25% on regulatory liabilities resulting from the difference of the fully phased-in rates to be applied in 2021 versus the phased-in rates refunded in the years leading up to 2021 (i.e., 2018 through 2020).

Rate Decision No. 76901, however, did not address the impacts of the TCJA on accumulated deferred income taxes ("ADIT"), including excess ADIT ("EADIT"). Following the ACC's request for a proposal, the Company made its proposal in filings on December 19, 2018 and July 1, 2019. ACC Staff reviewed the Company's filing and requested that the Company defer tariff revisions until such revisions can be considered in the next rate case. ACC Staff also requested that the Company defer consideration of the regulatory assets and regulatory liabilities associated with 2018 EADIT amortization. On July 18, 2019, the Company made a filing proposing these items be deferred to the next rate case. Refer to " — Corporate Transactions — ACC Rate Case" for additional information regarding the Company's next rate case.

On November 27, 2018, February 20, 2019, February 28, 2019, and January 23, 2020, the ACC adopted orders relating to the funding for income taxes on contributions in aid of construction (“CIAC”) and advances in aid of construction (“AIAC”) (which became taxable for our regulated utilities under the TCJA). Those orders 1) require that under the hybrid sharing method, a contributor will pay a gross-up to the utility consisting of 55% of the income tax expense with the utility covering the remaining 45% of the income tax expense; 2) remove the full gross-up method option for Class A and B utilities and their affiliates (which includes all of our utilities); 3) ensure proper ratemaking treatment of a utility using the self-pay method; 4) clarify that pass-through entities that are owned by a “C” corporation can recover tax expense according to methods allowed; and 5) require Class A and B utilities to self-pay the taxes associated with hook-up fee contributions but permit using a portion of the hook-up fees to fund these taxes. The Company’s utilities have adopted the hybrid sharing method for income tax on CIAC and AIAC.

#### *ACC Rate Case*

On April 26, 2019, the ACC issued Decision No. 77168, which required all of our utilities to file a rate case no later than June 30, 2020, using the twelve months ending December 31, 2019 as the test year for the rate case. Due to the COVID-19 pandemic, on April 14, 2020, we filed a request to extend the deadline for filing of a rate case to August 17, 2020. On May 5, 2020, the ACC extended the deadline to August 28, 2020.

On August 28, 2020, our regulated utilities each filed a rate case application with the ACC for water and wastewater rates, which proposed a collective revenue requirement increase of \$4.6 million (relative to expected revenues in 2021, which is the final year of the rate phase-in from the last rate case) based on a 2019 test year. Certain of our utilities, including Santa Cruz and Palo Verde, have also requested that the rate increases be phased in over three years, beginning January 1, 2022. The consolidated rate increase, if approved by the ACC, would result in the estimated average monthly residential bill for Santa Cruz and Palo Verde customers increasing approximately \$4.93, \$5.72, and \$4.12 in the aggregate in each of 2022, 2023, and 2024, respectively.

We also requested the consolidation of water and wastewater rates for our Red Rock, Santa Cruz, Palo Verde, Picacho Water and Picacho Utilities. These utilities are all located in Pinal County; make up approximately 97% of the Company’s active service connections; provide or will provide water, wastewater, and recycled water services; and are expected to create economies of scale that are beneficial to all customers if consolidated.

There can be no assurance, however, that the ACC will approve the requested rate increase or any increase or the consolidation of water and wastewater rates described above, and the ACC could take other actions as a result of the rate case. Further, it is possible that the ACC may determine to decrease future rates. There can also be no assurance as to the timing of when any approved rate increase (if any) would go into effect.

#### *2020 Common Stock Offering*

On January 21, 2020, the Company completed a public offering of 870,000 shares of common stock at a public offering price per share of \$12.50, for gross proceeds of \$10.9 million. On January 30, 2020, an additional 130,000 shares of common stock were issued at the public offering price of \$12.50 per share, for gross proceeds of \$1.6 million, resulting in total proceeds from the offering of approximately \$12.5 million. The issuance of the additional shares was completed pursuant to the exercise in full of the underwriter’s over-allotment option. Total net proceeds of approximately \$11.5 million were received after deducting underwriting discounts and commissions and offering expenses payable by us, which collectively totaled approximately \$1.0 million.

## **Significant Accounting Policies**

### *Basic and Diluted Earnings per Common Share*

Diluted EPS is based upon the weighted average number of common shares, including both outstanding shares and shares potentially issuable in connection with stock options and restricted stock awards granted.

As of September 30, 2020, the Company had 631,375 options outstanding to acquire an equivalent number of shares of GWRI common stock. The 385,771 options outstanding from the 2017 option grant equated to 32,339 and 34,696 common share equivalents for the three and nine months ended September 30, 2020, respectively, which were included within the calculation of diluted earnings per share for the three and nine months ended September 30, 2020. The remaining 245,604 options outstanding were not included within the calculation of diluted earnings per share for the three and nine months ended September 30, 2020, as to do so would be antidilutive. As of September 30, 2020 and 2019, there were 128,327 and zero restricted stock awards outstanding, respectively. The 128,327 restricted stock awards outstanding equated to 14,206 and zero common share equivalents for the three and nine months ended September 30, 2020, respectively. The 14,206 common share equivalents were included within the calculation of diluted earnings per share for the three months ended September 30, 2020.

As of September 30, 2019, the Company had 640,796 options outstanding to acquire an equivalent number of shares of GWRI common stock. The 390,796 options outstanding from the 2017 option grant equated to 34,406 and 11,485 common share equivalents for the three and nine months ended September 30, 2019, respectively, which were included within the calculation of diluted earnings per share for the three and nine months ended September 30, 2019. The 250,000 options outstanding from the 2019 option grant were not included for the three and nine months ended September 30, 2019 dilutive earnings per share calculation, as to do so would be antidilutive.

Refer to Note 14 – “Deferred Compensation Awards” for additional information regarding the option grants.

### *Customer payments in-transit*

Customer payments in-transit represent funds received by our third-party payment processor related to customer payments, a majority of which were paid for with debit cards, credit cards, and checks, to which the Company does not have immediate access but settles within a few days of the payment transaction.

## **Recent Accounting Pronouncements**

### *Recently Adopted Accounting Standards*

In August 2018, the Financial Accounting Standards Board ("FASB") issued ASU 2018-13, Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement (Topic 820) ("ASU 2018-13"). ASU 2018-13 changes the fair value disclosure requirements including new, eliminated, and modified disclosure requirements of ASC 820. Specifically, the ASU requires the addition of disclosures for Level 3 fair value measurements with unrealized gains and losses included in other comprehensive income and disclosure of the range and weighted average used to develop significant unobservable inputs for Level 3 measurements. The Company implemented ASU 2018-13 on January 1, 2020. The implementation did not result in material changes to our consolidated financial statements.

### *Future Adoption of Accounting Standards*

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”, or “ASC 842”). 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. In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842 ("ASU 2018-10"). ASU 2018-10 improves various aspects within ASC 842, such as rate implicit in the lease, lessee's reassessment of lease classification, lease term and purchase option, as well as many other aspects of the guidance. In July 2018, the FASB issued ASU 2018-11, Leases Topic 842, Targeted Improvements ("ASU 2018-11"). ASU 2018-11 provides entities the option to elect not to recast the comparative periods presented when transitioning to ASC 842 and lessors may elect not to separate lease and non-lease components when certain conditions are met. In November 2019, the FASB issued ASU 2019-10, Financial Instruments - Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842) ("ASU 2019-10"). ASU 2019-10 amends the effective dates for certain major new accounting standards including those related to leases. Due to qualifying as an emerging growth company, the Company is required to adopt all lease related ASUs on January 1, 2021. The

Company is currently assessing the impact that adopting these new standards will have on its consolidated financial statements but does not expect a material effect.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment ("ASU 2017-04"). ASU 2017-04 eliminates Step 2 from the impairment test which requires entities to determine the implied fair value of goodwill to measure if any impairment expense is necessary. Instead, entities will record impairment expenses based on the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. ASU 2019-10 extended the effective date for this ASU. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2023. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (Topic 350) ("ASU 2018-15"). ASU 2018-15 amends ASC 350 to include in its scope implementation costs of a Cloud Computing Arrangement ("CCA") that is a service contract and clarifies that a customer should apply ASC 350-40 to determine which implementation costs should be capitalized in a CCA that is considered a service contract. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2021. Early adoption is permitted, including adoption in any interim period. The Company is currently assessing the impact that adopting this new 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 ACC and meet the requirements for regulatory accounting found within Accounting Standards Codification 980, *Regulated Operations* ("ASC 980").

In accordance with ASC 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 as 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, not updated for the TCJA, refer to Note 1 — "Basis of Presentation, Corporate Transactions, Significant Accounting Policies, and Recent Accounting Pronouncements — Corporate Transactions— ACC Tax Docket" for further details):

	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 infrastructure coordination and financing agreements ("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 ICFA's. Existing ICFA's will remain in place, but a portion of future payments to be received under the ICFA's 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.

On September 20, 2018, the ACC issued Rate Decision No. 76901, which set forth the reductions in revenue for our Santa Cruz, Palo Verde, Greater Tonopah, and Northern Scottsdale utilities due to the TCJA. Rate Decision No. 76901 adopted a phase-in approach for the reductions to match the phase-in of our revenue requirements under Rate Decision No. 74364. Refer to Note 1 — "Basis of Presentation, Corporate Transactions, Significant Accounting Policies, and Recent Accounting Pronouncements — Corporate Transactions — ACC Tax Docket" for details regarding Rate Decision No. 76901.

On August 28, 2020, our regulated utilities each filed a rate case application with the ACC for water and wastewater rates, as well as the consolidation of water and wastewater rates for certain of the utilities. Refer to Note 1 — "Basis of Presentation, Corporate Transactions, Significant Accounting Policies, and Recent Accounting Pronouncements — Corporate Transactions— ACC Rate Case" for additional information.

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

**Infrastructure Coordination and Financing Agreements** – ICFA's 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 ICFA's, 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 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.

In February 2014, the ACC issued Rate Decision No. 74364, and concluded ICFA funds already received would no longer be deemed CIAC for rate making purposes. ICFA funds already received or which had become due prior to the date of Rate Decision No. 74364 were 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 September 30, 2020 and December 31, 2019, ICFA deferred revenue recorded on the consolidated balance sheet totaled \$17.4 million, which represents deferred revenue recorded for ICFA funds received on contracts that had become due prior to Rate Decision No. 74364. Refer to Note 3 — "Revenue Recognition" of the notes to the unaudited condensed consolidated financial statements for additional discussion regarding ICFA revenue.

**Intangible assets / Regulatory liability** – 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.

The intangible assets 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.

As of September 30, 2020, regulatory liability recorded on the consolidated balance sheet totaled \$8.3 million, of which \$7.0 million relates to the offset of intangible assets related to ICFA contracts obtained in connection with our Santa Cruz, Palo Verde, and Sonoran acquisitions, and the remaining \$1.3 million relates to the TCJA rate reduction mandated by the ACC pursuant to Rate Decision No. 76901.

### **3. REVENUE RECOGNITION**

On January 1, 2019, the Company adopted ASC 606, using the modified retrospective approach. The Company identified its sources of revenue streams that fall within the scope of this guidance and applied the five-step model to all qualifying revenue streams to determine when to recognize revenue. The Company concluded that there is not a material change to how revenue was recognized before and after the adoption of ASC 606; therefore, no cumulative retained earnings adjustment was required.

#### **Regulated Revenue**

The Company's operating revenues are primarily attributable to regulated services based upon tariff rates approved by the ACC. Regulated service revenues consist of amounts billed to customers based on approved fixed monthly fees and consumption fees, as well as unbilled revenues estimated from the last meter reading date to the end of the accounting period utilizing historical customer data recorded as accrued revenue. The measurement of sales to customers is generally based on the reading of their meters, which occurs on a systematic basis throughout the month. At the end of each month, the Company estimates consumption since the date of the last meter reading and a corresponding unbilled revenue is recognized. The unbilled revenue estimate is based upon the number of unbilled days that month and the average daily customer billing rate from the previous month (which fluctuates based upon customer usage). The Company applies the invoice practical expedient and recognizes revenue from contracts with customers in the amount for which the Company has a right to invoice. The Company has the right to invoice for the volume of consumption, service charge, and other authorized charges.

The Company satisfies its performance obligation to provide water and wastewater services over time as the services are rendered. Regulated services may be terminated by the customers at will, and, as a result, no separate financing component is recognized for the Company's collections from customers, which generally require payment within 15 days of billing. The Company applies judgment, based principally on historical payment experience, in estimating its customers' ability to pay.

The Company has elected to apply the sales tax practical expedient, whereby qualifying excise and other taxes collected from customers and remitted to governmental authorities are not included in reported revenues.

#### **Unregulated Revenue**

Unregulated revenues represent those revenues that are not subject to the ratemaking process of the ACC. Unregulated revenues are limited to rental revenue and imputed revenues resulting from a portion of ICFA funds received. ICFAs are agreements with developers and homebuilders where the Company 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. In return, the developers and homebuilders pay the Company an agreed-upon amount per dwelling unit for the specified development or portion of land. In addition, under ICFA agreements, the Company has a contractual obligation to ensure physical capacity exists through its regulated utilities for water and wastewater to the developer when needed. This obligation persists regardless of connection growth.

The Company believes that these services are not distinct in the context of the contract because they are highly interdependent with the Company's ability to provide fitted capacity for water and wastewater services. The Company concluded that the goods and services provided under ICFA contracts constitute a single performance obligation.

ICFA revenue is recognized at a point in time when the Company has the necessary capacity in place within its infrastructure to provide water/wastewater services to the developer. The Company exercises judgment when estimating the number of equivalent dwelling units that the Company has capacity to serve.

#### *Disaggregated Revenues*

For the three and nine months ended September 30, 2020 and 2019, disaggregated revenues from contracts with customers by major source and customer class are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
<b>REGULATED REVENUE</b>				
Water Services				
Residential	\$ 3,623	\$ 3,151	\$ 9,564	\$ 8,652
Irrigation	1,297	1,320	2,528	2,452
Commercial	224	228	642	583
Construction	169	37	388	104
Other water revenues	179	227	433	553
Total water revenues	5,492	4,963	13,555	12,344
Wastewater and recycled water services				
Residential	4,516	4,293	13,411	12,698
Commercial	244	229	721	678
Recycled water revenues	419	335	891	717
Other wastewater revenues	59	105	164	300
Total wastewater and recycled water revenues	5,238	4,962	15,187	14,393
<b>TOTAL REGULATED REVENUE</b>	<b>10,730</b>	<b>9,925</b>	<b>28,742</b>	<b>26,737</b>
<b>UNREGULATED REVENUE</b>				
ICFA revenues	—	—	—	—
Rental revenues	26	16	133	48
Other Miscellaneous revenues	1	1	1	1
<b>TOTAL UNREGULATED REVENUE</b>	<b>27</b>	<b>17</b>	<b>134</b>	<b>49</b>
<b>TOTAL REVENUE</b>	<b>\$ 10,757</b>	<b>\$ 9,942</b>	<b>\$ 28,876</b>	<b>\$ 26,786</b>

*Contract Balances*

Our contract assets and liabilities consist of the following (in thousands):

	September 30, 2020	December 31, 2019
<b>CONTRACT ASSETS</b>		
Accounts receivable		
Water services	\$ 1,296	\$ 791
Wastewater and recycled water services	1,013	926
Total contract assets <sup>(1)</sup>	\$ 2,309	\$ 1,717
<b>CONTRACT LIABILITIES</b>		
Deferred revenue - ICFA	\$ 17,446	\$ 17,372
Refund liability - regulated <sup>(2)</sup>	695	587
Deferred revenue - other <sup>(3)</sup>	10	—
Total contract liabilities	\$ 18,151	\$ 17,959

(1) The increase in accounts receivable was due to the increase in customers at September 30, 2020 compared to December 31, 2019, combined with the seasonality of the business with higher usage in hotter summer months.

(2) The increase in refund liability is due to the phase-in approach approved in Rate Decision No. 76901. Refer to Note 1—"Basis of Presentation, Corporate Transactions, Significant Accounting Policies, and Recent Accounting Pronouncements — Corporate Transactions — ACC Tax Docket" of the notes to the unaudited condensed consolidated financial statements for further details.

(3) The increase in deferred revenue - other is due to a new rental contract entered into during the three months ended March 31, 2020, for which rental payments were collected in advance.

*Remaining Performance Obligations*

Revenue allocated to remaining performance obligations represents contracted revenue that has not yet been recognized, which includes deferred revenue and amounts that will be invoiced and recognized as revenue in future periods. Contracted revenue expected to be recognized in future periods was approximately \$17.4 million at both September 30, 2020 and December 31, 2019. Deferred revenue - ICFA 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. Due to the uncertainty of future events, the Company is unable to estimate when to expect recognition of deferred revenue - ICFA. Deferred revenue - other is recognized as revenue once the obligations specified with the rental contract are met. The Company expects to recognize the full amount in the next three months.

#### 4. PROPERTY, PLANT AND EQUIPMENT

Property, plant, and equipment at September 30, 2020 and December 31, 2019 consist of the following (in thousands):

	<u>September 30, 2020</u>	<u>December 31, 2019</u>	<u>Average Depreciation Life (in years)</u>
Mains/lines/sewers	\$ 142,903	\$ 138,173	49
Plant	95,892	94,615	31
Equipment	36,877	35,497	14
Meters	14,385	14,057	13
Furniture, fixture and leasehold improvements	1,650	623	21
Computer and office equipment	991	785	7
Software	241	241	3
Land and land rights	1,147	1,051	
Other	700	700	
Construction work-in-process	39,983	40,561	
Total property, plant and equipment	<u>334,769</u>	<u>326,303</u>	
Less accumulated depreciation	<u>(98,351)</u>	<u>(92,749)</u>	
Net property, plant and equipment	<u>\$ 236,418</u>	<u>\$ 233,554</u>	

#### 5. ACCOUNTS RECEIVABLE

Accounts receivable as of September 30, 2020 and December 31, 2019 consist of the following (in thousands):

	<u>September 30, 2020</u>	<u>December 31, 2019</u>
Billed receivables	\$ 2,284	\$ 1,718
Less allowance for doubtful accounts	(138)	(87)
Accounts receivable – net	<u>\$ 2,146</u>	<u>\$ 1,631</u>

#### 6. EQUITY METHOD INVESTMENT

In 2018, the Company had an investment in a limited partnership, FATHOM Water Management Holdings, LLP, which, through subsidiaries, owned Global Water Management, LLC ("GWM"). This investment was accounted for under the equity method due to the investment being considered more than minor. In December of 2019, GWM ceased to provide substantially all of the billing, customer service, and other support services previously provided to its customers, including the Company's regulated utilities. The carrying value of this investment is zero as of both September 30, 2020 and December 31, 2019.

## 7. ACQUISITIONS

### *Acquisition of Turner*

On May 30, 2018, the Company acquired all of the equity of Turner, a rate regulated non-potable irrigation water utility in Mesa, Arizona, for total consideration of \$2.8 million. This acquisition is consistent with the Company's declared strategy of making accretive acquisitions. At the time of acquisition, Turner had 963 residential irrigation connections and approximately seven square miles of service area. The acquisition was accounted for as a business combination under ASC 805, "*Business Combinations*." The purchase price was allocated to the acquired utility assets and liabilities assumed based on the seller's book value at acquisition as the historical cost of these assets and liabilities will be the amounts that will continue to be reflected in customer rates.

Final purchase price allocation of the net assets acquired in the transaction is as follows (in thousands):

Net assets acquired:		
Cash	\$	176
Accounts receivable		121
Gross property, plant and equipment		4,495
Construction work-in-progress		92
Accumulated depreciation		(3,554)
Accounts payable		(30)
Accrued expenses		(49)
Total net assets assumed		1,251
Goodwill		1,549
Total purchase price	\$	2,800

The revenue and earnings recognized post acquisition and the pro forma effect of the business acquired are not material to the Company's financial position or results of operations.

### *Acquisition of Red Rock*

On October 16, 2018, the Company acquired Red Rock, a rate-regulated operator of a water and a wastewater utility with service areas in the Pima and Pinal counties of Arizona, for total consideration of \$5.9 million. This acquisition is consistent with the Company's declared strategy of making accretive acquisitions. The acquisition added over 1,650 connections and approximately nine square miles of service area. The acquisition was accounted for as a business combination under ASC 805, "*Business Combinations*." The purchase price was allocated to the acquired utility assets and liabilities assumed based on the seller's book value at acquisition as the historical cost of these assets and liabilities will be the amounts that will continue to be reflected in customer rates.

Under the terms of the purchase agreement, the Company is obligated to pay to the seller a growth premium equal to \$750 for each new account established within three specified growth premium areas, commencing in each area on the date of the first meter installation and ending on the earlier of ten years after such first installation date or twenty years from the acquisition date. The three specified growth premium areas are located in Pima County, Arizona where Red Rock has not yet begun operating, and where Red Rock is authorized to provide water utility services only. As of September 30, 2020, no meters have been installed and no accounts have been established in any of the three growth premium areas. The fair value of the acquisition liability was determined based on management's estimates and assumptions regarding the probability that connection growth will be achieved during the growth premium period. Any subsequent adjustments to the fair value estimate will be recorded to earnings. Refer to Note 11 — "Fair Value" of the notes to the unaudited condensed consolidated financial statements for additional information.

## [Table of Contents](#)

Final purchase price allocation of the net assets acquired in the transaction, reflecting additional information discussed above is as follows (in thousands):

Net assets acquired:		
Accounts receivable	\$	111
Gross property, plant and equipment		19,841
Construction work-in-progress		748
Accumulated depreciation		(6,084)
Prepays		12
Intangibles <sup>1</sup>		196
Accounts payable		(26)
Other taxes		(14)
Other accrued liabilities		(47)
Customer and meter deposits		(76)
AIAC		(3,423)
CIAC - Net		(7,397)
Acquisition liability		(838)
Total net assets assumed		3,003
Goodwill		2,848
Total purchase price	\$	<u>5,851</u>

<sup>1</sup> Intangibles consist of franchise contract rights and organizational costs. Refer to Note 8 — "Goodwill & Intangible Assets" of the notes to the unaudited condensed consolidated financial statements for additional discussion.

The revenue and earnings recognized post acquisition and the pro forma effect of the business acquired are not material to the Company's financial position or results of operations.

## **8. GOODWILL AND INTANGIBLE ASSETS**

### **Goodwill**

As of September 30, 2020, the goodwill balance of \$4.4 million related to the Turner and Red Rock acquisitions. There were no indicators of impairment identified as a result of the Company's review of events and circumstances related to its goodwill subsequent to the acquisitions. Based on our annual impairment testing performed on November 1st, no impairment was recorded. Refer to Note 7 — "Acquisitions" of the notes to the unaudited condensed consolidated financial statements for additional discussion.

## Intangible Assets

As of September 30, 2020 and December 31, 2019, intangible assets consisted of the following (in thousands):

	September 30, 2020			December 31, 2019		
	Gross Amount	Accumulated Amortization	Net Amount	Gross Amount	Accumulated Amortization	Net Amount
<b>INDEFINITE LIVED INTANGIBLE ASSETS:</b>						
CP Water Certificate of Convenience & Necessity service area	\$ 1,532		\$ 1,532	\$ 1,532		\$ 1,532
Intangible trademark	13		13	13		13
Franchise contract rights	129		129	129		129
Organizational costs	67		67	67		67
	<u>1,741</u>		<u>1,741</u>	<u>1,741</u>		<u>1,741</u>
<b>DEFINITE LIVED INTANGIBLE ASSETS:</b>						
Acquired ICFAs	17,978	(13,396)	4,582	17,978	(12,568)	5,410
Sonoran contract rights	7,406	(2,003)	5,403	7,406	(2,003)	5,403
	<u>25,384</u>	<u>(15,399)</u>	<u>9,985</u>	<u>25,384</u>	<u>(14,571)</u>	<u>10,813</u>
<b>Total intangible assets</b>	<b>\$ 27,125</b>	<b>\$ (15,399)</b>	<b>\$ 11,726</b>	<b>\$ 27,125</b>	<b>\$ (14,571)</b>	<b>\$ 12,554</b>

A Certificate of Convenience & Necessity ("CC&N") is a permit issued by the ACC allowing a public service corporation to serve a specified area, and preventing other public service corporations from offering the same services within the specified area. The CP Water CC&N intangible asset was acquired through the acquisition of CP Water Company in 2006. CC&N permits are expected to be renewable indefinitely.

Franchise contract rights and organizational costs relate to our 2018 acquisition of Red Rock. Franchise contract rights are agreements with Pima and Pinal counties that allow the Company to place infrastructure in public right-of-way and permits expected to be renewable indefinitely. The organizational costs represent fees paid to federal or state governments for the privilege of incorporation and expenditures incident to organizing the corporation and preparing it to conduct business.

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. Amortization expense of \$0.6 million and \$0.8 million was recorded during the three and nine months ended September 30, 2020, respectively. No amortization was recorded for these balances during the three and nine months ended September 30, 2019.

## 9. 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 \$0.2 million and \$0.1 million for the three months ended September 30, 2020 and 2019, respectively. Medical claims paid to the plan were approximately \$0.5 million and \$0.3 million for the nine months ended September 30, 2020 and 2019, respectively.

As GWM was previously owned by the Company, it had historically provided billing, customer service, and other support services for the Company's regulated utilities. In connection with the sale of GWM in 2013, the Company agreed to use the FATHOM platform for all of its regulated utility services for an initial term of 10 years pursuant to a services agreement. 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.

On September 10, 2019, the services agreement was amended and restated to, among other things, revise the scope of services to reflect upgrades and improvements to the FATHOM platform. Pursuant to the amended and restated agreement, GWM agreed to continue providing billing, customer service, and other support services for the Company's regulated utilities at a monthly rate of \$6.43 per managed account.

As previously disclosed, based on the breach of the services agreement and cessation of services by GWM on December 20, 2019, the Company considers the services agreement to be terminated effective on that date.

Pursuant to the services agreement, the Company was 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, of which \$2.3 million was received over the six year period. Accordingly, following the termination of the services agreement on December 20, 2019, the Company will no longer receive such royalty payments for periods after such date. During 2020, no FATHOM royalties were received and zero service fees were incurred. For the three months ended September 30, 2019, the FATHOM royalties received totaled approximately \$0.1 million and service fees incurred were \$0.4 million. For the nine months ended September 30, 2019, the FATHOM royalties received totaled approximately \$0.3 million and service fees incurred were \$1.3 million.

## 10. ACCRUED EXPENSES

Accrued expenses at September 30, 2020 and December 31, 2019 consist of the following (in thousands):

	<u>September 30, 2020</u>	<u>December 31, 2019</u>
Deferred compensation	\$ 1,284	\$ 2,008
Property taxes	1,774	1,095
Interest	1,778	475
Dividend payable	544	519
Asset retirement obligation	697	697
Accrued Bonus	702	344
Other accrued liabilities	1,836	2,408
Total accrued expenses	<u>\$ 8,615</u>	<u>\$ 7,546</u>

## 11. FAIR VALUE

### *Fair Value of Financial Instruments*

FASB ASC 820 establishes a fair value hierarchy that distinguishes between assumptions based on market data (observable inputs) and the Company's assumptions (unobservable inputs). The hierarchy consists of three levels, as follows:

- Level 1 - Quoted market prices in active markets for identical assets or liabilities
- Level 2 - Inputs other than Level 1 that are either directly or indirectly observable
- Level 3 - Unobservable inputs developed using the Company's estimates and assumptions, which reflect those that the Company believes market participants would use.

[Table of Contents](#)

Financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2020 and December 31, 2019 were as follows (in thousands):

Asset/Liability Type:	September 30, 2020				December 31, 2019			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
HUF Funds - restricted cash <sup>(1)</sup>	\$ —	\$ 1,526	\$ —	\$ 1,526	\$ —	\$ 627	\$ —	\$ 627
Demand Deposit <sup>(2)</sup>	2,135	—	—	2,135	2,132	—	—	2,132
Certificate of Deposit - Restricted <sup>(1)</sup>	—	790	—	790	—	705	—	705
Long-term debt <sup>(3)</sup>	—	128,060	—	128,060	—	121,075	—	121,075
Acquisition Liability <sup>(4)</sup>	—	—	838	838	—	—	838	838
<b>Total</b>	<b>\$ 2,135</b>	<b>\$130,376</b>	<b>\$ 838</b>	<b>\$133,349</b>	<b>\$ 2,132</b>	<b>\$122,407</b>	<b>\$ 838</b>	<b>\$125,377</b>

(1) HUF Funds - restricted cash and Certificate of Deposit - Restricted are presented on the Restricted cash line item of the Company's consolidated balance sheets and are valued at amortized cost, which approximates fair value.

(2) Demand Deposit is presented on the Cash and cash equivalents line item of the Company's consolidated balance sheets and is valued at amortized cost, which approximates fair value.

(3) The fair value of our debt was estimated based on interest rates considered available for instruments of similar terms and remaining maturities.

(4) As part of the Red Rock acquisition, the Company is required to pay to the seller a growth premium equal to \$750 for each new account established within three specified growth premium areas, commencing in each area on the date of the first meter installation and ending on the earlier of ten years after such first installation date, or twenty years from the acquisition date. The fair value of the acquisition liability was calculated using a discounted cash flow technique which utilized unobservable inputs developed using the Company's estimates and assumptions. Significant inputs used in the fair value calculation are as follows: year of the first meter installation, total new accounts per year, years to complete full build out, and discount rate.

## 12. DEBT

The outstanding balances and maturity dates for short-term (including the current portion of long-term debt) and long-term debt as of September 30, 2020 and December 31, 2019 are as follows (in thousands):

	September 30, 2020		December 31, 2019	
	Short-term	Long-term	Short-term	Long-term
<b>BONDS AND NOTES PAYABLE -</b>				
4.38% Series A 2016, maturing June 2028	\$ —	\$ 28,750	\$ —	\$ 28,750
4.58% Series B 2016, maturing June 2036	—	86,250	—	86,250
4.65% Harquahala Loan, maturing January 2021	4	—	6	3
4.60% WIFA Loan, maturing March 2037	—	—	1	15
	4	115,000	7	115,018
<b>OTHER</b>				
Capital lease obligations	114	165	110	251
Debt issuance costs	—	(571)	—	(605)
<b>Total debt</b>	<b>\$ 118</b>	<b>\$ 114,594</b>	<b>\$ 117</b>	<b>\$ 114,664</b>

### ***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 our initial public offering in the United States. 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. Debt issuance costs as of both September 30, 2020 and December 31, 2019 were \$0.6 million.

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 and amortization, 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. The debt service ratio increases to 1.25 for any fiscal quarter during the period from and after June 30, 2024. As of September 30, 2020, the Company was in compliance with its financial debt covenants.

### ***Eagletail Loans***

In May 2017, the Company acquired Eagletail Water Company ("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"). The WIFA loan bore 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. The Company paid off the WIFA loan in March 2019.

In 2017, the Company entered into a second loan payable to WIFA ("2017 WIFA"), and no borrowings were made until 2018. The 2017 WIFA loan bore an interest rate of 4.60% over a 20-year term. The original loan amount was approximately \$175,000, of which approximately \$157,000 was forgiven. The Company paid off the 2017 WIFA loan in February 2020.

### ***Revolving Credit Line***

On April 20, 2018, the Company entered into an agreement with MidFirst Bank, a federally chartered savings association (the "MidFirst Bank Loan Agreement"), for a two-year revolving line of credit up to \$8.0 million. The credit facility bore an interest rate equal to the London Interbank Offered Rate (LIBOR) plus 2.25%. In April 2019, the Company signed an amendment to the MidFirst Bank Loan Agreement, which extended the maturity of the line of credit to April 30, 2022 and modified the debt service coverage ratio to match the ratio required by the senior secured notes discussed above; all other terms remained unchanged. In April 2020, the Company terminated the MidFirst Bank Loan Agreement and entered into a loan agreement with Northern Trust Company, an Illinois banking corporation (the "Northern Trust Company Loan Agreement"), for a new two-year revolving line of credit up to \$10.0 million with a maturity date of April 30, 2022. This new credit facility, which may be used to refinance existing indebtedness, to acquire assets to use and/or expand the Company's business, and for general corporate purposes, bears an interest rate equal to LIBOR plus 2.00% and has no unused line fee. As of September 30, 2020, the Company had no outstanding borrowings under this credit line. There were \$57,000 and \$49,000 unamortized debt issuance costs as of September 30, 2020 and December 31, 2019, respectively.

The Northern Trust Company Loan Agreement requires the Company to maintain a debt service coverage ratio of consolidated EBITDA to consolidated debt service of at least 1.10 to 1.00. The Northern Trust Company Loan Agreement also contains 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, 2022, the ratio drops to 1.20. As of September 30, 2020, the Company was in compliance with its financial debt covenants.

At September 30, 2020, 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
Remaining three months of 2020	\$ 2	\$ 28
2021	1,920	115
2022	3,833	88
2023	3,833	48
2024	3,833	—
Thereafter	101,583	—
Subtotal	115,004	279
Less: amount representing interest	—	(15)
Total	\$ 115,004	\$ 264

### 13. INCOME TAXES

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) was enacted into law in response to the widespread economic impact of the COVID-19 pandemic. The CARES Act includes several business tax and employer focused provisions intended to improve cash flow and liquidity. Though the business tax provisions are not expected to have a material impact on our tax rate in 2020, we are reviewing the employer focused provisions beneficial to our business. We will continue to monitor all the relevant provisions under the CARES Act as additional guidance is released.

During the three months ended September 30, 2020, the Company recorded a tax expense of \$0.5 million on pre-tax income of \$1.6 million compared to a tax expense of \$0.4 million on pre-tax income of \$1.4 million for the three months ended September 30, 2019. During the nine months ended September 30, 2020, the Company recorded tax expense of \$0.7 million on pre-tax income of \$2.1 million compared to a tax expense of \$1.1 million on pre-tax income of \$3.6 million for the nine months ended September 30, 2019. The income tax provision was computed based on the Company’s estimated effective tax rate and forecasted income expected for the full year, including the impact of any unusual, infrequent, or non-recurring items.

### 14. 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.

#### *2017 stock option grant*

Stock-based compensation expense of \$67,000 was recorded for both the three months ended September 30, 2020 and 2019, and \$200,000 and \$198,000 was recorded for the nine months ended September 30, 2020 and 2019, respectively. As of September 30, 2020, 11,279 options have been exercised and 67,950 options have been forfeited with 385,771 outstanding.

#### *2019 stock option grant*

Stock-based compensation expense of \$49,000 and \$26,000 was recorded for the three months ended September 30, 2020 and 2019, respectively, and \$146,000 and \$26,000 was recorded for the nine months ended September 30, 2020 and 2019, respectively. As of September 30, 2020, 4,396 options have been forfeited with 245,604 options outstanding.

**Phantom stock compensation**

The following table details total awards granted and the number of units outstanding as of September 30, 2020 along with the amounts paid to holders of the phantom stock units ("PSUs") for the three and nine months ended September 30, 2020 and 2019 (in thousands, except unit amounts):

Grant Date	Units Granted	Units Outstanding	Amounts Paid For the Three Months Ended September 30,		Amounts Paid For the Nine Months Ended September 30,	
			2020	2019	2020	2019
Q1 2016	34,830	—	—	—	—	29
Q1 2017	22,712	—	—	19	24	57
Q1 2018	30,907	5,151	26	26	85	78
Q1 2019	32,190	16,095	27	27	89	54
Q1 2020	22,481	18,734	19	—	38	—
Total	143,120	39,980	\$ 72	\$ 72	\$ 236	\$ 218

**Stock appreciation rights compensation**

The following table details the recipients of the stock appreciation rights ("SARs") awards, the grant date, units granted, exercise price, outstanding units as of September 30, 2020 and amounts paid during the three and nine months ended September 30, 2020 and 2019 (in thousands, except unit and per unit amounts):

Recipients	Grant Date	Units Granted	Exercise Price	Units Outstanding	Amounts Paid For the Three Months Ended September 30,		Amounts Paid For the Nine Months Ended September 30,	
					2020	2019	2020	2019
Members of Management <sup>(1)(2)</sup>	Q1 2015	299,000	\$ 4.26	118,000	—	481	—	481
Key Executives <sup>(3)(4)</sup>	Q2 2015	300,000	\$ 5.13	42,500	—	258	300	705
Members of Management <sup>(1)(5)</sup>	Q3 2017	103,000	\$ 9.40	63,000	—	125	—	125
Members of Management <sup>(1)(6)</sup>	Q1 2018	33,000	\$ 8.99	24,750	—	27	—	27
Total		735,000		248,250	\$ —	\$ 891	\$ 300	\$ 1,338

- (1) The SARs vest ratably over sixteen quarters from the grant date.
- (2) 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.
- (3) The SARs vest over sixteen quarters, vesting 20% per year for the first three years, with the remainder, 40%, vesting in year four.
- (4) 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.
- (5) 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.
- (6) 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.

For the three months ended September 30, 2020 and 2019, the Company recorded approximately \$0.2 million and \$0.6 million of compensation expense related to the PSUs and SARs, respectively. For the nine months ended September 30, 2020 and 2019, the Company recorded approximately \$0.3 million of negative compensation expense and \$1.0 million of compensation expense related to the PSUs and SARs, respectively. Based on GWRI's closing share price on September 30, 2020 (the last trading date of the quarter), deferred compensation expense to be recognized over future periods is estimated for the years ending December 31 as follows (in thousands):

	PSUs	SARs
Remaining three months of 2020	\$ 153	\$ 9
2021	195	38
2022	80	38
2023	—	32
2024	—	—
Total	<u>\$ 428</u>	<u>\$ 117</u>

### Restricted stock compensation

On May 7, 2020, the Company's stockholders approved the Global Water Resources, Inc. 2020 Omnibus Incentive Plan which allows restricted stock awards as a form of compensation. A restricted stock award ("RSA") represents the right to receive a share of the Company's common stock. RSAs vest over two to three years, beginning on the date of the grant. The Company assumes that forfeitures will be minimal and recognizes forfeitures as they occur, which results in a reduction in compensation expense. During the three and nine months ended September 30, 2020, 177,490 RSAs were issued. For the three and nine months ended September 30, 2020, the Company recorded approximately \$0.2 million and \$0.8 million of compensation expense related to the grant and partial vesting of RSAs, respectively. No compensation expense was recorded for the three and nine months ended September 30, 2019. The following table summarizes the RSA transactions for the three months ended September 30, 2020:

	Number of RSAs	Weighted Average Fair Value
Granted	177,490	\$ 11.25
Stock units vested and issued	49,163	\$ 11.32
Forfeited	—	—
Nonvested RSAs at end of period	<u>128,327</u>	\$ 11.22

## 15. SUPPLEMENTAL CASH FLOW INFORMATION

The following is supplemental cash flow information for the nine months ended September 30, 2020 and 2019 (in thousands):

	For the Nine Months Ended September 30,	
	2020	2019
Supplemental cash flow information:		
Cash paid for interest	\$ 2,616	\$ 2,621
Non-cash financing and investing activities:		
Capital expenditures included in accounts payable and accrued liabilities	\$ 294	\$ 964
Contributions in aid of construction - loan forgiveness	\$ —	\$ 31

## 16. COMMITMENTS AND CONTINGENCIES

### Commitments

In September 2018, the Company's corporate office lease agreement was amended to include the rental of additional office space for the period of September 1, 2018 through February 28, 2019. In January 2019, the lease agreement was amended to extend the term of the lease, with a commencement date of March 1, 2019 and termination date of May 31, 2022. As such, the Company's monthly rent expense increased to approximately \$15,000. Rent expense arising from the operating leases totaled approximately \$44,000 and 45,000 for the three months ended September 30, 2020 and 2019, respectively, and \$133,000 for both the nine months ended September 30, 2020 and 2019.

### 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.

## 17. SUBSEQUENT EVENTS

### *Acquisition of Mirabell Water Co., Inc.*

On October 29, 2020, the Company completed the acquisition of Mirabell Water Co., Inc., an operator of a water utility with service area in the Pima county of Arizona, for a purchase price of \$80,000. The acquisition added over 60 connections.

### *Dividend Increase*

On November 5, 2020, the Company announced a monthly dividend increase from \$0.0241 per share (\$0.2892 per share annually) to \$0.02434 per share (\$0.29208 per share annually). Although we expect monthly dividends will be declared and paid for in the foreseeable future, the declaration of any dividends is at the discretion of our board of directors and is subject to our compliance with applicable law, and depending on, among other things, results of operation, financial condition, level of indebtedness, capital requirements, contractual restrictions, restrictions in our debt agreements and in any preferred stock we may issue in the future, business prospects, and other factors that our board of directors may deem relevant.

## **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 and nine months ended September 30, 2020 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, 2019 available on our Company’s profile on the Securities and Exchange Commission (“SEC”) website, [www.sec.gov](http://www.sec.gov).*

### **Cautionary Statement Regarding Forward-Looking Statements**

Certain statements in this Quarterly Report on Form 10-Q (this “Form 10-Q”) of the Company and documents incorporated herein by reference 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”, “objective”, “goal”, “focus”, “aim”, “should”, “could”, “may”, and similar expressions. These forward-looking statements include, but are not limited to, statements about our strategies; expectations about future business plans, prospective performance, and opportunities, including potential acquisitions; future financial performance; regulatory proceedings and approvals, including anticipated timing and outcomes; population and growth projections; technologies; revenues; metrics; operating expenses; market trends, including those in the markets in which we operate; liquidity; cash flows and uses of cash; dividends; amount and timing of capital expenditures; depreciation and amortization; tax payments; hedging arrangements; our ability to repay indebtedness and invest in initiatives; impact and resolutions of legal matters; the impact of tax reform; the impact of accounting changes and other pronouncements; and the anticipated impacts from the COVID-19 pandemic on the Company, including to our business operations, results of operations, cash flows, and financial position, and our future responses to the COVID-19 pandemic. 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 Part I, Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2019 filed with the SEC and in Part II, Item 1A in this Form 10-Q, as updated from time to time in our subsequent filings with the SEC. Although the forward-looking statements 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. Further, any forward-looking statement speaks only as of the date of this Form 10-Q. Except as required by law, we undertake no obligation to publicly release the results of any revision to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

### **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.

### **COVID-19 Update**

In late 2019, a novel strain of coronavirus (COVID-19) was reported to have surfaced in Wuhan, China. In March 2020, the World Health Organization declared the COVID-19 outbreak a pandemic, and the President of the United States declared COVID-19 a national emergency. The outbreak has resulted in government authorities around the world implementing numerous measures to try to reduce the spread of the COVID-19 pandemic, such as travel bans and restrictions, quarantines, shelter-in-place, stay-at-home, or total lock-down (or similar) orders and business limitations and shutdowns. For example, the State of Arizona has implemented several orders promoting physical distancing, limiting certain activities, and restricting the operations of certain businesses, including restaurants, bars, gyms, theaters, and water parks.

Our water and wastewater services are essential services and we intend to continue to provide those services for our customers. Further, we continue to monitor the impact of COVID-19 pandemic on our business and operations, including how it will impact our customers, employees, suppliers, vendors and, business partners. While the COVID-19 pandemic did not have a material effect on our business operations, results of operations, cash flows, and financial position for the three and nine months ended September 30, 2020, we are unable to predict the ultimate extent to which our business operations, results of operations, cash flows, and financial position will ultimately be impacted by the COVID-19 pandemic due to the fluid and rapidly evolving situation.

We voluntarily agreed not to disconnect customers or charge late fees as a result of the economic hardships caused by the COVID-19 pandemic, such as due to the loss of employment by our customers, which has led to a small increase in uncollectable accounts. We also expanded our customer assistance program to include a larger customer base, while increasing the annual maximum benefit and including additional qualifying categories to include disabled veterans, deployed service members, furloughed workers, and customers with a medical hardship. As of September 30, 2020, COVID-19 did not have a material impact on uncollectable accounts. However, we believe that we may be unable to collect a portion of billed revenue for some period of time, if at all. Therefore, we could see a negative impact to our revenue, earnings, and cash flows due to the COVID-19 pandemic as this continues through 2020. Further, our current results and financial condition discussed herein may not be indicative of future operating results and trends. Refer to “Risk Factors” included in Part II, Item 1A of this Form 10-Q for additional risks we face due to the COVID-19 pandemic.

### **Business Outlook**

2019 and the first three quarters of 2020 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 metropolitan area will have a population of 5.7 million people by 2030 and 6.5 million by 2040. During the twelve months ended September 30, 2020, Arizona’s employment rate decreased by 3.1%, ranking the state in the top five nationally for job growth.

We believe that our utilities and service areas are directly in the anticipated path of growth primarily in the Phoenix metropolitan 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 the Phoenix metropolitan area. Management believes that we are well-positioned to benefit from growth in the Phoenix metropolitan area 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.

The COVID-19 pandemic may impact the degree to which these factors affect our financial condition and results of operations as discussed above under "COVID-19 Update."

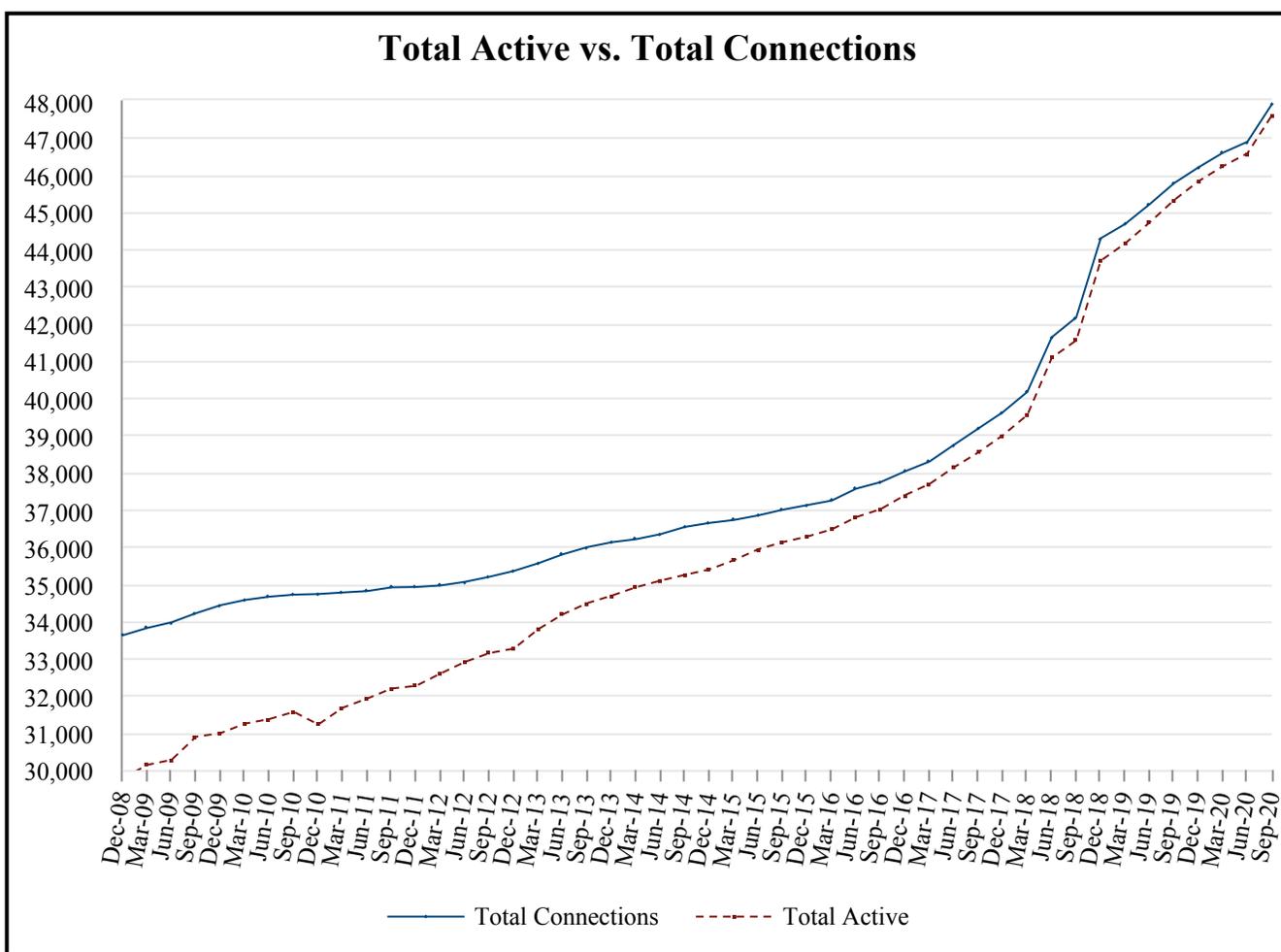
We are subject to economic regulation by the state regulator, the Arizona Corporation Commission (“ACC”). The U.S. federal and state governments also regulate environmental, health and safety, and water quality matters. We continue to execute on our strategy to optimize and focus the Company in order 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 2,123 connections, or 4.6% (4.9% annualized growth), from a total of 45,770 as of September 30, 2019 to 47,893 as of September 30, 2020. This increase is due to organic growth in new connections.

As of September 30, 2020, active service connections increased 2,279, or 5.0% (5.2% annualized growth), to 47,594 compared to 45,315 active service connections as of September 30, 2019. As with the increase in total service connections, the increase is due to organic growth in new connections. Approximately 93.1% of the 47,594 active service connections are serviced by our Global Water - Santa Cruz Water Company, Inc. (“Santa Cruz”) and Global Water - Palo Verde Utilities Company, Inc. (“Palo Verde”) utilities as of September 30, 2020.

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”).



**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 in 2014 and extended new rate phase-in period, we have not initiated the next rate case on this timeline. On August 28, 2020, our regulated utilities each filed a rate case application with the ACC for water and wastewater rates, as well as the consolidation of water and wastewater rates for certain of the utilities. Refer to “—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 fifteen years, and because the infrastructure remains in the early stages of its useful life, 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 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 (the "IRS"). Refer to "—Corporate Transactions—Private Letter Ruling" for additional information.

We may reduce capital expenditures in the future, but will, in any event, continue to invest in maintenance related capital expenditures and perform those projects that are necessary to continue providing services.

### ***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. 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 water services revenue and wastewater services 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, not updated for the Federal Tax Cuts and Jobs Act (the "TCJA"), refer to "—Corporate Transactions—ACC Tax Docket" for further details):

	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.

On September 20, 2018, the ACC issued Rate Decision No. 76901, which set forth the reductions in revenue for our Santa Cruz, Palo Verde, Greater Tonopah and Northern Scottsdale utilities due to the TCJA. Rate Decision No. 76901 adopted the phase-in approach for the reductions to match the phase-in of our revenue requirement under Rate Decision No. 74364. Refer to "—Corporate Transactions — ACC Tax Docket" for details regarding Rate Decision No. 76901.

On August 28, 2020, our regulated utilities each filed a rate case application with the ACC for water and wastewater rates, as well as the consolidation of water and wastewater rates for certain of the utilities. Refer to "—Corporate Transactions — ACC Rate Case" for additional information.

### ***ICFA Treatment***

From 2003 to 2008, we entered into approximately 154 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.

With the issuance of Rate Decision No. 74364, in February 2014, the ACC changed how ICFA funds would be characterized and accounted for going forward. Most notably, the ACC changed the rate treatment of ICFA funds. 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 less than 30% of the ICFA fee as deferred revenue.

We 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.

Pursuant to Rate Decision No. 74364, 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.

In addition to ICFAs, we have various line extension agreements with developers and builders, through which 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 is 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. On November 27, 2018, the ACC ruled that the utility may require that the contributor pay a gross-up to the utility consisting of 55% of the income tax expense with the utility covering the remaining 45% of the income tax expense. For more details regarding the ruling, refer to "—Corporate Transactions — ACC Tax Docket."

## **Corporate Transactions**

### ***Stipulated Condemnation of the Operations and Assets of Valencia***

On July 14, 2015, we 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 \$0.1 million 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.

### ***Private Letter Ruling***

On June 2, 2016, we received a Private Letter Ruling from the IRS 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.

Pursuant to Internal Revenue Code §1033, we would have been able to defer the gain on condemnation through the end of 2017, which was subsequently extended through the end of 2020. The Company fully deferred the remaining tax liability during the nine months ended September 30, 2020.

### ***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 which was paid to us over time as certain milestones were met between EPCOR and the developers/landowners of the Loop 303 Corridor. As of December 31, 2018, we had

received \$3.1 million of the proceeds and in March 2019, we received the final payment of \$1.0 million. These proceeds were recorded as other income.

### ***Revolving Credit Line***

On April 30, 2020, the Company entered into an agreement with The Northern Trust Company, an Illinois banking corporation, for a two-year revolving line of credit up to \$10.0 million with a maturity date of April 30, 2022. This new credit facility, which may be used to refinance existing indebtedness, to acquire assets to use in and/or expand the Company's business, and for general corporate purposes, bears an interest rate equal to the London Interbank Offered Rate (LIBOR) plus 2.00% and has no unused line fee. This new credit facility replaced the previous revolving line of credit with MidFirst Bank, which was terminated in April 2020.

### ***ACC Tax Docket***

On December 20, 2017, the ACC opened a docket to address the utility ratemaking implications of the TCJA. The ACC subsequently approved an order in February 2018 requiring Arizona utilities 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.

On September 20, 2018, the ACC issued Rate Decision No. 76901, which set forth the reductions in revenue for our Santa Cruz, Palo Verde, Greater Tonopah, and Northern Scottsdale utilities due to lower corporate tax rates under the TCJA. Rate Decision No. 76901 adopted a phase-in approach for the reductions to match the phase-in of our revenue requirement under the Rate Decision No. 74364 enacted in February 2014. In 2019, the aggregate annual reductions in revenue for our Santa Cruz, Palo Verde, Greater Tonopah, and Northern Scottsdale utilities were approximately \$890,000. In 2021, the final year of the phase-in, the aggregate annual reductions in revenue for our Santa Cruz, Palo Verde, Greater Tonopah, and Northern Scottsdale utilities will be approximately \$1.1 million. The ACC also approved a carrying cost of 4.25% on regulatory liabilities resulting from the difference of the fully phased-in rates to be applied in 2021 versus the phased-in rates refunded in the years leading up to 2021 (i.e., 2018 through 2020).

Rate Decision No. 76901, however, did not address the impacts of the TCJA on accumulated deferred income taxes ("ADIT"), including excess ADIT ("EADIT"). Following the ACC's request for a proposal, the Company made its proposal in filings on December 19, 2018 and July 1, 2019. ACC Staff reviewed the Company's filing and requested that the Company defer tariff revisions until such revisions can be considered in the next rate case. ACC Staff also requested that the Company defer consideration of the regulatory assets and regulatory liabilities associated with 2018 EADIT amortization. On July 18, 2019, the Company made a filing proposing these items be deferred to the next rate case. Refer to " — Corporate Transactions — ACC Rate Case" for additional information regarding the Company's next rate case.

On November 27, 2018, February 20, 2019, February 28, 2019, and January 23, 2020, the ACC adopted orders relating to the funding for income taxes on CIAC and AIAC (which became taxable for our regulated utilities under the TCJA). Those orders 1) require that under the hybrid sharing method, a contributor will pay a gross-up to the utility consisting of 55% of the income tax expense with the utility covering the remaining 45% of the income tax expense; 2) remove the full gross-up method option for Class A and B utilities and their affiliates (which includes all of our utilities); 3) ensure proper ratemaking treatment of a utility using the self-pay method; 4) clarify that pass-through entities that are owned by a "C" corporation can recover tax expense according to methods allowed; and 5) require Class A and B utilities to self-pay the taxes associated with hook-up fee contributions but permit using a portion of the hook-up fees to fund these taxes. The Company's utilities have adopted the hybrid sharing method for income tax on CIAC and AIAC.

### ***ACC Rate Case***

On April 26, 2019, the ACC issued Decision No. 77168, which required all of our utilities to file a rate case no later than June 30, 2020, using the twelve months ending December 31, 2019 as the test year for the rate case. Due to the COVID-19 pandemic, on April 14, 2020, we filed a request to extend the deadline for filing of a rate case to August 17, 2020. On May 5, 2020, the ACC extended the deadline to August 28, 2020.

On August 28, 2020, our regulated utilities each filed a rate case application with the ACC for water and wastewater rates, which proposed a collective revenue requirement increase of \$4.6 million (relative to expected revenues in 2021, which is the final year of the rate phase-in from the last rate case) based on a 2019 test year. Certain of our utilities, including Santa Cruz and Palo Verde, have also requested that the rate increases be phased in over three years, beginning January 1, 2022. The consolidated rate increase, if approved by the ACC, would result in the estimated average monthly residential bill for Santa

Cruz and Palo Verde customers increasing approximately \$4.93, \$5.72, and \$4.12 in the aggregate in each of 2022, 2023, and 2024, respectively.

We also requested the consolidation of water and wastewater rates for our Red Rock, Santa Cruz, Palo Verde, Picacho Water and Picacho Utilities. These utilities are all located in Pinal County; make up approximately 97% of the Company's active service connections; provide or will provide water, wastewater, and recycled water services; and are expected to create economies of scale that are beneficial to all customers if consolidated.

There can be no assurance, however, that the ACC will approve the requested rate increase or any increase or the consolidation of water and wastewater rates described above, and the ACC could take other actions as a result of the rate case. Further, it is possible that the ACC may determine to decrease future rates. There can also be no assurance as to the timing of when any approved rate increase (if any) would go into effect.

### ***Acquisition of Red Rock Utilities***

On October 16, 2018, we completed the acquisition of Red Rock, an operator of a water and a wastewater utility with service areas in Pima and Pinal counties of Arizona, for a purchase price of \$5.9 million. The acquisition added over 1,650 connections and approximately 9 square miles of service area. The Company is obligated to pay to the seller a growth premium equal to \$750 for each new account established within three specified growth premium areas, commencing in each area on the date of the first meter installation and ending on the earlier of ten years after such first installation date or twenty years from the acquisition date. The three specified growth premium areas are located in Pima County, Arizona where Red Rock has not yet begun operating, and where Red Rock is authorized to provide water utility services only. As of September 30, 2020, no meters have been installed and no accounts have been established in any of the three growth premium areas. We believe this acquisition is consistent with the Company's declared strategy of making accretive acquisitions.

### **Recent Events**

#### ***2020 Common Stock Offering***

On January 21, 2020, we completed a public offering of 870,000 shares of common stock at a public offering price per share of \$12.50, for gross proceeds of \$10.9 million. On January 30, 2020, we issued an additional 130,000 shares of common stock at the public offering price of \$12.50 per share, for gross proceeds of \$1.6 million, resulting in total proceeds from the offering of approximately \$12.5 million. The issuance of the additional shares was completed pursuant to the exercise in full of the underwriter's over-allotment option. We received total net proceeds of approximately \$11.5 million after deducting underwriting discounts and commissions and offering expenses payable by us, which collectively totaled approximately \$1.0 million.

#### ***Application for Certificate of Convenience & Necessity ("CC&N") for Inland Port Project***

On June 24, 2020, we submitted our application for a CC&N for the Inland Port Project located in Pinal County. We anticipate its approval before the end of the year. We see this project benefiting us in multiple ways, including adding, for the first time, a large industrial service area to our portfolio which we believe will drive commercial and residential growth in the surrounding area.

#### ***Acquisition of Mirabell Water Co., Inc.***

On October 29, 2020, the Company completed the acquisition of Mirabell Water Co., Inc., an operator of a water utility with service area in the Pima county of Arizona, for a purchase price of \$80,000. The acquisition added over 60 connections.

### **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.

### Comparison of Results of Operations for the Three Months Ended September 30, 2020 and 2019

The following table summarizes our results of operations for the three months ended September 30, 2020 and 2019 (in thousands, except per share amounts):

	For the Three Months Ended September 30,	
	2020	2019
Revenues	\$ 10,757	\$ 9,942
Operating expenses	7,865	7,380
Operating income	2,892	2,562
Total other expense	(1,263)	(1,127)
Income before income taxes	1,629	1,435
Income tax expense	(498)	(388)
Net income	\$ 1,131	\$ 1,047
Basic earnings per common share	\$ 0.05	\$ 0.05
Diluted earnings per common share	\$ 0.05	\$ 0.05

**Revenues** – The following table summarizes our revenues for the three months ended September 30, 2020 and 2019 (in thousands):

	For the Three Months Ended September 30,	
	2020	2019
Water services	\$ 5,492	\$ 4,963
Wastewater and recycled water services	5,238	4,962
Unregulated revenues	27	17
Total revenues	\$ 10,757	\$ 9,942

Total revenues increased \$0.8 million, or 8.2%, to \$10.8 million for the three months ended September 30, 2020 compared to \$9.9 million for the three months ended September 30, 2019. This increase reflects the 5.0% increase in active service connections, combined with increases in consumption and the increase in rates related to Rate Decision No. 74364.

*Water Services* – Water services revenue increased \$0.5 million, or 10.7%, to \$5.5 million for the three months ended September 30, 2020 compared to \$5.0 million for the three months ended September 30, 2019. The increase in water services revenues is primarily related to increased consumption and growth in connections.

Water services revenue based on consumption increased \$0.5 million, or 18.8%, to \$3.2 million for the three months ended September 30, 2020 compared to \$2.7 million for the three months ended September 30, 2019. The increase was primarily driven by increased residential consumption for the three months ended September 30, 2020 compared to the three months ended September 30, 2019.

Active water connections increased 5.0% to 24,674 as of September 30, 2020 from 23,508 as of September 30, 2019, primarily due to the growth in our service areas.

Water consumption increased 12.6% to 1.1 billion gallons for the three months ended September 30, 2020 from 986 million gallons for the three months ended September 30, 2019. The increase in consumption was primarily related to an increase in residential consumption.

Water services revenue associated with the basic service charge, excluding miscellaneous charges, increased \$0.1 million, or 5.0%, to \$2.3 million for the three months ended September 30, 2020. The increase was primarily driven by 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 \$0.3 million, or 5.6%, to \$5.2 million for the three months ended September 30, 2020 compared to \$5.0 million for the three months ended September 30, 2019. The increase in wastewater and recycled water services revenue included a \$0.2 million increase in wastewater services revenue. The increase in wastewater services revenue reflects the increase in active wastewater connections, which increased 5.1% to 22,920 as of September 30, 2020, from 21,807 as of September 30, 2019, 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 \$0.1 million, or 25.3%, to \$0.4 million for the three months ended September 30, 2020 compared to the three months ended September 30, 2019. The increase in recycled water services revenue was primarily related to the increase in recycled water consumption, coupled with an increase in rates related to Rate Decision No. 74364. The volume of recycled water delivered increased 46 million gallons, or 20.4%, to 273 million gallons for the three months ended September 30, 2020 compared to 226 million gallons for the three months ended September 30, 2019.

**Operating Expenses** – The following table summarizes our operating expenses for the three months ended September 30, 2020 and 2019 (in thousands):

	<b>For the Three Months Ended September 30,</b>	
	<b>2020</b>	<b>2019</b>
Operations and maintenance	\$ 2,584	\$ 1,914
Operations and maintenance - related party	—	435
General and administrative	2,969	3,074
Depreciation and amortization	2,312	1,957
<b>Total operating expenses</b>	<b>\$ 7,865</b>	<b>\$ 7,380</b>

Until December 2019, when it ceased operations, Global Water Management, LLC (“GWM”) provided substantially all of the billing, customer service, and other support services for the Company’s regulated utilities. When GWM ceased operations, we brought the customer service and billing operations in-house and entered into new contract services agreements to replace the services previously provided by GWM through its FATHOM platform. As described further below, this transition resulted in increased operations and maintenance expense and the elimination of contract services – related party expenses. Additionally, the Company no longer receives royalty payments that were previously based upon a percentage of certain of GWM’s recurring revenue, which was historically recorded as Other – related party income.

*Operations and Maintenance* – Operations and maintenance costs, consisting of personnel costs, production costs (primarily chemicals and purchased power), maintenance costs, and property tax, increased \$0.7 million, or 35.0%, to \$2.6 million for the three months ended September 30, 2020 compared to \$1.9 million for the three months ended September 30, 2019.

Total personnel expenses increased \$0.3 million, or 48.8%, to \$0.8 million for the three months ended September 30, 2020 compared to the three months ended September 30, 2019, primarily due to the hiring of additional employees to bring the customer service and billing operations in-house as discussed above, coupled with an increase in other employee benefits expense.

Contract services increased \$0.3 million for the three months ended September 30, 2020 compared to the three months ended September 30, 2019 as a result of new services agreements we entered into in connection with the FATHOM transition.

*Operations and maintenance - related party* - Operations and maintenance - related parties expenses decreased \$0.4 million to zero for the three months ended September 30, 2020 compared to the three months ended September 30, 2019 as a result of the FATHOM transition.

*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 decreased \$0.1 million, or 3.4%, to \$3.0 million for the three months ended September 30, 2020 compared to \$3.1 million for the three months ended September 30, 2019.

Deferred compensation expense decreased \$0.3 million to \$0.4 million for the three months ended September 30, 2020, from \$0.7 million for the three months ended September 30, 2019. The decrease was primarily driven by lower stock appreciation rights (“SARs”) expense for the current year period due to the decrease in stock price for the three months ended September 30, 2020 compared to the increase in stock price for the three months ended September 30, 2019. The decrease was partially offset by restricted stock awards granted and partially vested during the three months ended June 30, 2020. Refer to Note 14 — “Deferred Compensation Awards” of the Notes to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q for additional information.

Personnel and related expenses increased \$0.3 million to \$1.3 million for the three months ended September 30, 2020, from \$1.1 million for the three months ended September 30, 2019. The increase was primarily related to increases in salaries and bonuses due to the hiring of additional employees, coupled with increases in other employee benefits expense for the three months ended September 30, 2020, compared to the three months ended September 30, 2019.

Professional fees decreased \$0.2 million to \$0.2 million for the three months ended September 30, 2020, from \$0.3 million for the three months ended September 30, 2019. The decrease was primarily related to professional fees for rate case expenses incurred as we requested a portion of the expenses to be included in the rate case filed on August 28, 2020.

*Depreciation and amortization* - Depreciation and amortization expense increased \$0.4 million, or 18.1%, to \$2.3 million for the three months ended September 30, 2020, from \$2.0 million for the three months ended September 30, 2019. The increase was primarily driven by increased depreciation due to the increase in fixed assets, coupled with amortization of intangible assets.

**Other Expense** – Other expense increased \$0.1 million to \$1.3 million for the three months ended September 30, 2020, from \$1.1 million for the three months ended September 30, 2019. The increase in other expense was primarily attributed to the elimination of the FATHOM royalty.

**Income Tax Expense** – Income tax expense increased \$0.1 million to \$0.5 million for the three months ended September 30, 2020 compared to \$0.4 million for the three months ended September 30, 2019. The increase was driven by an increase in pretax income.

**Net Income** – Net income totaled \$1.1 million for the three months ended September 30, 2020 compared to net income of \$1.0 million for the three months ended September 30, 2019. The increase was primarily attributed to the \$0.3 million increase in operating income, which was driven by the increase in operating revenues, partially offset by increases in operations and maintenance expenses.

**Comparison of Results of Operations for the Nine Months Ended September 30, 2020 and 2019**

The following table summarizes our results of operations for the nine months ended September 30, 2020 and 2019 (in thousands, except per share amounts):

	For the Nine Months Ended September 30,	
	2020	2019
Revenues	\$ 28,876	\$ 26,786
Operating expenses	22,460	20,780
Operating income	6,416	6,006
Total other expense	(4,312)	(2,446)
Income before income taxes	2,104	3,560
Income tax expense	(741)	(1,086)
Net income	\$ 1,363	\$ 2,474
Basic earnings per common share	\$ 0.06	\$ 0.12
Diluted earnings per common share	\$ 0.06	\$ 0.11

**Revenues** – The following table summarizes our revenues for the nine months ended September 30, 2020 and 2019 (in thousands):

	For the Nine Months Ended September 30,	
	2020	2019
Water services	\$ 13,555	\$ 12,344
Wastewater and recycled water services	15,187	14,393
Unregulated revenues	134	49
Total revenues	<u>\$ 28,876</u>	<u>\$ 26,786</u>

Total revenues increased \$2.1 million, or 7.8%, to \$28.9 million for the nine months ended September 30, 2020 compared to \$26.8 million for the nine months ended September 30, 2019. The increase in revenue reflects the 5.0% increase in active service connections, combined with increases in consumption and the increase in rates related to Rate Decision No. 74364.

*Water Services* – Water services revenue increased \$1.2 million, or 9.8%, to \$13.6 million for the nine months ended September 30, 2020 compared to \$12.3 million for the nine months ended September 30, 2019. The increase in water services revenues primarily related to growth in connections and increased consumption.

Water services revenue based on consumption increased \$1.1 million, or 19.7%, to \$6.7 million for the nine months ended September 30, 2020 compared to \$5.6 million for the nine months ended September 30, 2019. This increase was primarily driven by increases in residential and construction consumption for the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019.

Active water connections increased 5.0% to 24,674 as of September 30, 2020 from 23,508 as of September 30, 2019, primarily due to the growth in our service areas.

Water consumption increased 12.4% to 2.5 billion gallons for the nine months ended September 30, 2020 from 2.2 billion gallons for the nine months ended September 30, 2019. The increase in consumption was primarily related to the increase in residential and construction consumption.

Water services revenue associated with the basic service charge, excluding miscellaneous charges, increased \$0.3 million, or 4.6%, to \$6.8 million for the nine months ended September 30, 2020 compared to \$6.5 million for the nine months ended September 30, 2019. The increase was primarily due to the 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 \$0.8 million, or 5.5%, for the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019. The increase in wastewater and recycled water services revenue was driven by a \$0.6 million increase in wastewater services revenue. The increase in wastewater services revenue reflects the increase in active wastewater connections, which increased 5.1% to 22,920 as of September 30, 2020, from 21,807 as of September 30, 2019, 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 \$0.2 million, or 24.2%, to \$0.9 million for the nine months ended September 30, 2020 compared to \$0.7 million for the nine months ended September 30, 2019. The increase in recycled water services revenue was primarily driven by the increase in rates related to Rate Decision No. 74364.

**Operating Expenses** – The following table summarizes our operating expenses for the nine months ended September 30, 2020 and 2019 (in thousands):

	For the Nine Months Ended September 30,	
	2020	2019
Operations and maintenance	\$ 7,156	\$ 5,417
Operations and maintenance - related party	—	1,287
General and administrative	8,682	8,099
Depreciation and amortization	6,622	5,977
Total operating expenses	<u>\$ 22,460</u>	<u>\$ 20,780</u>

*Operations and Maintenance* – Operations and maintenance costs, consisting of personnel costs, production costs (primarily chemicals and purchased power), maintenance costs, and property tax, increased \$1.7 million, or 32.1%, to \$7.2 million for the nine months ended September 30, 2020 compared to \$5.4 million for the nine months ended September 30, 2019.

Total personnel expenses increased \$0.7 million, or 45.7%, to \$2.2 million for the nine months ended September 30, 2020 compared to \$1.5 million for the nine months ended September 30, 2019, primarily due to the hiring of additional employees to bring the customer service and billing operations in-house as discussed above, coupled with an increase in other employee benefits expense.

Contract services increased \$0.7 million to \$0.9 million for the nine months ended September 30, 2020 compared to \$0.2 million for the nine months ended September 30, 2019, primarily due to new services agreements we entered into in connection with the FATHOM transition.

*Operations and maintenance - related party* - Operations and maintenance - related parties expenses decreased \$1.3 million to zero, for the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019 as a result of the FATHOM transition.

*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 \$0.6 million, or 7.2%, to \$8.7 million for the nine months ended September 30, 2020 compared to \$8.1 million for the nine months ended September 30, 2019.

Personnel and related expenses increased \$0.9 million, or 31.9%, to \$3.8 million for the nine months ended September 30, 2020 compared to \$2.9 million for the nine months ended September 30, 2019. The increase was primarily related to increases in salaries and bonuses due to the hiring of additional employees, coupled with increases in other employee benefit expense for the nine months ended September 30, 2020, compared to the nine months ended September 30, 2019.

Board compensation expenses decreased \$0.4 million, or 71.7%, to \$0.1 million for the nine months ended September 30, 2020 compared to \$0.5 million for the nine months ended September 30, 2019. The decrease was primarily related to a \$0.3 million decrease in Deferred Phantom Unit liability which was primarily driven by the decrease in stock price for the nine months ended September 30, 2020 compared to the increase in stock price for the nine months ended September 30, 2019.

Deferred compensation expense decreased \$0.2 million to \$1.0 million for the nine months ended September 30, 2020, from \$1.2 million for the nine months ended September 30, 2019. The decrease was primarily driven by lower SARs expense for the current year period due to the decrease in stock price for the nine months ended September 30, 2020 compared to the increase in stock price for the nine months ended September 30, 2019. The decrease was partially offset by restricted stock awards granted and partially vested during the three months ended June 30, 2020. Refer to Note 14 — “Deferred Compensation Awards” of the Notes to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q for additional information.

*Depreciation and amortization* - Depreciation and amortization expense increased \$0.6 million, or 10.8%, to \$6.6 million for the nine months ended September 30, 2020, from \$6.0 million for the nine months ended September 30, 2019. The increase was primarily driven by increased depreciation due to the increase in fixed assets, coupled with amortization of intangible assets.

**Other Expense** – Other expense totaled \$4.3 million for the nine months ended September 30, 2020 compared to other expense of \$2.4 million for the nine months ended September 30, 2019. The increase of \$1.9 million in other expense was primarily attributed to the receipt of the remaining \$1.0 million of proceeds in March 2019 relating to the Loop 303 Contracts, which was recorded as other income for the nine months ended September 30, 2019. The increase was also due to the \$0.6 million expense related to loss on asset disposals recognized during the nine months ended September 30, 2020, as well as the elimination of the FATHOM royalty.

**Income Tax Expense** – Income tax expense decreased \$0.3 million, or 31.8%, to \$0.7 million for the nine months ended September 30, 2020 compared to \$1.1 million for the nine months ended September 30, 2019. The decrease was driven by a decrease in pretax income.

**Net Income** – Net income totaled \$1.4 million for the nine months ended September 30, 2020 compared to net income of \$2.5 million for the nine months ended September 30, 2019. The \$1.1 million decrease was primarily attributed to the \$1.9 million increase in total other expense for the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019 resulting from the final payout pursuant to the Loop 303 contracts received in the first quarter of 2019, combined with

the loss on asset disposals recognized during the nine months ended September 30, 2020. The increase in other expense was partially offset by the \$0.4 million increase in operating income for the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019.

### **Outstanding Share Data**

As of November 2, 2020, there were 22,586,726 shares of our common stock outstanding and stock based awards to acquire an additional 759,702 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.

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 September 30, 2020, 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, the ability to draw on our new \$10.0 million revolver, 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. However, our near term cash flow may be impacted by the COVID-19 pandemic. Refer to “—COVID-19 Update” and “Risk Factors” included in Part II, Item 1A of this Form 10-Q for additional discussion relating to the COVID-19 pandemic.

In March 2014, we initiated a dividend program to declare and pay a monthly dividend. On November 5, 2020, we announced a monthly dividend increase from \$0.0241 per share (\$0.2892 per share annually) to \$0.02434 per share (\$0.29208 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” and “—Revolving Credit Line”).

#### *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 nine months ended September 30, 2020, our net cash provided by operating activities totaled \$11.7 million compared to \$11.2 million for the nine months ended September 30, 2019. The \$0.5 million increase in cash from operating activities was primarily driven by a decrease in payments related to other current liabilities of \$0.9 million for the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019. The increase was partially offset by the increase in other expense of \$0.6 million due to the loss on disposal of fixed assets for the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019.

### *Cash from Investing Activities*

Our net cash used in investing activities totaled \$7.5 million for the nine months ended September 30, 2020 compared to \$7.8 million for the nine months ended September 30, 2019. The \$0.3 million decrease in cash used in investing activities was primarily driven by a decrease in capital expenditures of \$0.3 million for the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019.

We continue to invest capital prudently in our existing, core service areas where we are able to deploy our Total Water Management model as. This includes any required maintenance capital expenditures and the construction of new water and wastewater treatment and delivery facilities. 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 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 IRS. Refer to “—Corporate Transactions—Private Letter Ruling” for additional information. Our projected capital expenditures and other investments are subject to periodic review and revision to reflect changes in economic conditions and other factors. In particular, we continue to monitor the rapidly evolving COVID-19 pandemic. We may reduce capital expenditures in the future, but will, in any event, continue to invest in maintenance related capital expenditures and perform those projects that are necessary to continue providing services.

### *Cash from Financing Activities*

Our net cash provided by financing activities totaled \$7.1 million for the nine months ended September 30, 2020 compared to \$4.5 million in cash used by financing activities for the nine months ended September 30, 2019. This change was primarily driven by the \$11.5 million in net proceeds received from our public offering of stock in January 2020 as well as increased AIAC of \$0.8 million, partially offset by the \$0.4 million decrease in proceeds from stock option exercise.

### *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 our 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 and amortization, 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. The debt service ratio increases to 1.25 for any fiscal quarter during the period from and after June 30, 2024. As of September 30, 2020, the Company was in compliance with its financial debt covenants.

Debt issuance costs as of both September 30, 2020 and December 31, 2019 were \$0.6 million.

### *Revolving Credit Line*

On April 30, 2020, the Company entered into an agreement with The Northern Trust Company, an Illinois banking corporation (the “Northern Trust Loan Agreement”), for a two-year revolving line of credit up to \$10.0 million with a maturity date of April 30, 2022. This new credit facility, which may be used to refinance existing indebtedness, to acquire assets to use in and/or expand the Company’s business, and for general corporate purposes, bears an interest rate equal to LIBOR plus 2.00% and has no unused line fee. This new credit facility replaced the previous revolving line of credit with MidFirst Bank, which was terminated in April 2020.

Similar to the senior secured notes, the Northern Trust Loan Agreement requires the Company to maintain a debt service coverage ratio of consolidated EBITDA to consolidated debt service of at least 1.10 to 1.00. The Northern Trust Loan Agreement also contains 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, 2022, the ratio drops to 1.20. Additionally, the Northern Trust Loan Agreement 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 (including dividends); engage in certain affiliate transactions; and change the nature of the business. The foregoing covenants were subject to various qualifications and limitations as set forth in the Northern Trust Loan Agreement. Pursuant to the Northern Trust Loan Agreement, the revolving credit facility is subject to certain customary events of default after which the revolving credit facility could be declared due and payable if not cured within the grace period or, in certain circumstances, could be declared due and payable immediately. Refer to Note 12 — "Debt" of the Notes to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q for additional information. As of September 30, 2020, the Company was in compliance with its financial debt covenants.

As of September 30, 2020, the Company had no outstanding borrowings under this credit line with Northern Trust Bank. The Company incurred \$73,000 debt issuance costs as of September 30, 2020 related to the Northern Trust Loan Agreement.

### **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 5, 2020.

### **Off Balance Sheet Arrangements**

As of September 30, 2020 and December 31, 2019, we did not have any off-balance sheet arrangements.

## **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 currently outstanding long-term debt is based on fixed rates, changes in interest rates could impact the fair market value of such long-term debt. As of September 30, 2020, the fair market value of the Company's long-term debt was \$128.1 million. For additional information about the Company's long-term debt, refer to Note 12 — "Debt" of the Notes to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q for additional information.

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 Officer and Chief Financial Officer, reviewed and evaluated our disclosure controls and procedures (as such term is defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), as of the end of the period covered by this Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

### *Change in Internal Control over Financial Reporting*

There was no change in our internal control over financial reporting (as such term is defined under Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the fiscal quarter ended September 30, 2020 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

In addition to the other information set forth in this report, you should carefully consider the factors discussed in “Risk Factors” included in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2019. There have been no material changes in our risk factors from those discussed in “Risk Factors” included in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2019 other than as disclosed below.

***The recent COVID-19 pandemic could have a material adverse effect on our business operations, results of operations, cash flows and financial position.***

In late 2019, a novel strain of coronavirus (COVID-19) was reported to have surfaced in Wuhan, China. In March 2020, the World Health Organization declared the COVID-19 outbreak a pandemic, and the President of the United States declared COVID-19 a national emergency. The outbreak has resulted in government authorities around the world implementing numerous measures to try to reduce the spread of COVID-19 pandemic, such as travel bans and restrictions, quarantines, shelter-in-place, stay-at-home or total lock-down (or similar) orders and business limitations and shutdowns. For example, the State of Arizona has implemented several orders promoting physical distancing, limiting certain activities, and restricting the operations of certain businesses, including restaurants, bars, gyms, theaters, and water parks.

While the COVID-19 pandemic did not have a material effect on our business operations, results of operations, cash flows, and financial position for the three and nine months ended September 30, 2020, our business operations, results of operations, cash flows, and financial position may be adversely impacted in a number of ways, including due to related responses from government authorities.

For example, near term cash flow may be impacted by the COVID-19 pandemic. In particular, we have voluntarily agreed not to disconnect customers or charge late fees as a result of the economic hardships caused by the COVID-19 pandemic, such as due to the loss of employment by our customers, which has led to a small increase in uncollectable accounts. Accordingly, we believe that we may be unable to collect a portion of billed revenue for some period of time, if at all.

Other potential impacts include, but are not limited to, the following:

- disruptions to our operations and business activities, including any closures of offices or facilities, and to those of governmental agencies regulating our business, suppliers, customers, and other business partners;
- reduced demand for our water and wastewater services from our commercial customers, particularly as businesses are shutdown;
- a slowdown or disruption in the supply chain for the supplies used in our operations, including chemicals used to treat water and wastewater, in addition to higher costs;
- limitations on employee resources and availability, including due to sickness, government restrictions, and the desire of employees to avoid contact with large groups of people;
- potential legislative or regulatory efforts to impose new requirements on our operations;
- an increase in the cost or the difficulty to obtain debt or equity financing could affect our financial condition or future investment opportunities; and
- an increase in regulatory restrictions or continued market volatility could hinder our ability to execute strategic business activities, including acquisitions, as well as negatively impact our stock price.

The spread of the COVID-19 has caused us to modify our business practices (including additional cybersecurity measures, employee travel, employee work locations, and cancellation of physical participation in meetings, events and conferences), and we may take further actions as may be required by government authorities or that we determine are prudent to support the well-

being of our employees, customers, suppliers, business partners and others. There is no certainty that such measures will be sufficient to mitigate the risks posed by the virus, and our ability to perform critical functions could be harmed.

Additionally, the COVID-19 pandemic could affect our internal controls over financial reporting as a portion of our workforce is required to work from home and therefore new processes, procedures, and controls could be required to respond to changes in our business environment. Further, should any key employees become ill from COVID-19 and unable to work, the attention of the management team could be diverted.

Any of the foregoing could adversely affect our business operations, results of operations, cash flows, and financial position. The potential effects of the COVID-19 pandemic may also impact our other risk factors discussed in “Risk Factors” included in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2019. The ultimate extent of the impact of the COVID-19 pandemic on our business operations, results of operations, cash flows, and financial position, including our ability to execute our business strategies and initiatives in the expected time frame, will depend on future developments, which are highly uncertain, continuously evolving and cannot be predicted. This includes, but is not limited to, the duration and spread of the COVID-19 pandemic, its severity, the actions to contain the virus or treat its impact, such as related restrictions on travel and transportation, and how quickly and to what extent normal economic and operating conditions can resume.

## **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 September 30, 2020.

### ***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**

<b>Exhibit Number</b>	<b>Description of Exhibit</b>	<b>Method of Filing</b>
2.1.1	<a href="#">Arrangement Agreement</a>	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	<a href="#">Plan of Arrangement</a>	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	<a href="#">Second Amended and Restated Certificate of Incorporation of Global Water Resources, Inc.</a>	Incorporated by reference to Exhibit 3.1 of the Company's Form 8-K filed May 4, 2016.
3.2	<a href="#">Amended and Restated Bylaws of Global Water Resources, Inc.</a>	Incorporated by reference to Exhibit 3.2 of the Company's Form 8-K filed May 4, 2016.
31.1	<a href="#">Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer</a>	Filed herewith.
31.2	<a href="#">Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer</a>	Filed herewith.
32.1	<a href="#">Section 1350 Certification of Chief Executive Officer and Chief Financial Officer</a>	Furnished herewith.
101.INS	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document	Filed herewith.
101.SCH	Inline XBRL Taxonomy Extension Schema Document	Filed herewith.
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith.
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith.
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document	Filed herewith.
101. PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document	Filed herewith.
104	Cover Page Interactive Data File (formatted as Inline XBRL with applicable taxonomy extension information contained in Exhibits 101)	Filed herewith.

