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Global Water Resources, Inc.

Second Quarter 2018 Conference Call

August 9, 2018

CORPORATE PARTICIPANTS

Joanne Ellsworth, *Vice President, Corporate & Regulatory Affairs*

Ron Fleming, *Chief Executive Officer, President & Director*

Michael Liebman, *Senior Vice President, Chief Financial Officer & Corporate Secretary*

CONFERENCE CALL PARTICIPANTS

Gerard Sweeney, *Roth Capital Partners*

PRESENTATION

Operator:

Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to the Global Water Resources, Inc. 2018 Second Quarter Conference Call. At this time, all participants are in listen-only mode. Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up for questions. If anyone has any difficulties hearing the conference, please press star, zero for Operator assistance at any time.

I would like to remind everyone that this call is being recorded on August 9, 2018, at 1:00 p.m. Eastern Time. I would now like to turn the conference over to Joanne Ellsworth, VP of Corporate and Regulatory Affairs. Please go ahead.

Joanne Ellsworth:

Good morning, everyone, and thank you for joining us on today's call. Yesterday, we issued our 2018 second quarter financial results by press release, a copy of which is available on our website at www.gwresources.com.

Speaking today is Ron Fleming, President and Chief Executive Officer; and Mike Liebman, Chief Financial Officer. Mr. Fleming will summarize the key events of the quarter, following which Mr. Liebman will review the financial results for the quarter ended June 30, 2018. Mr. Fleming and Mr. Liebman will be available for questions at the end of the call.

Before we begin, I'd like to remind you that certain information presented today may include forward-looking statements. Such statements reflect the Company's current expectations, estimates, projections and assumptions regarding future events. These forward-looking statements involve a number of assumptions, risks, uncertainties, estimates and other factors that could cause actual results to differ materially from those contained in the forward-looking statements. Accordingly, investors are cautioned not to place undue reliance on any forward-looking statements, which reflect Management's views as of the date hereof and are not guarantees of future performance.

For additional information regarding factors that may affect future results, please read the sections Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations included within our latest Form 10-K and 10-Q filed with the SEC. Such filings are available at www.sec.gov.

Certain non-GAAP measures may be included within today's call. For a reconciliation of these measures to the comparable GAAP financial measures, please see the tables included in yesterday's press release, which is available on our website.

Unless otherwise stated, all amounts discussed are in U.S. dollars.

I'll now turn the call over to Mr. Fleming.

Ron Fleming:

Thank you, Joanne. Good afternoon, everyone, and thank you for joining us today. We are very pleased to report our second quarter and year-to-date 2018 results as the employees of Global Water continue to deliver exceptional performance, both financially and operationally. Highlights include: revenues increased 33.1% to $10.8 million, driven primarily by a $2.4 million recognition of revenue under infrastructure coordination and financing agreements, or ICFAs, in connection with the substantial completion of capital improvements that increased the capacity of our Palo Verde wastewater utilities reclamation facility. Mike Liebman will discuss ICFA revenue recognition more later in the call.

The increase in revenues was also due to growth in active connections of 7.8% and approved rate increases. Adjusting out the $2.4 million onetime revenue recognition, regulated utility revenue increased 3.8% to $8.4 million, primarily due to the organic growth and the acquisition of Turner Ranches Water and Sanitation Company.

I will note that there is only one month of additional revenue from Turner Ranches in the Q2 numbers.

The increase was partially offset by reductions due to tax reform totaling $378,000. Without the revenue reduction caused by tax reform, regulated utility revenues would be up $685,000 or 8.4%. Mike Liebman will also cover the tax reform matter in more detail.

Net income increased by $1.8 million to $2.3 million or $0.11 per share, and we declared three monthly cash dividends equating to $0.2835 per share on an annualized basis.

Total active connections increased 7.8% as of quarter close and over—or over the trailing 12 months, with an organic connection growth rate of 5.7% on an annualized basis from December 31, 2017.

We completed the purchase of Turner Ranches Water and Sanitation Company, a nonpotable irrigation water utility in Mesa, Arizona, which added 963 connections and signed the letter of intent to acquire a Class D water utility and a class D wastewater utility, with plans to close the acquisitions on an accelerated basis as early as Q3 2018.

Subsequent to the second quarter, we raised net proceeds of approximately $14.7 million in an equity offering to fund acquisitions, provide working capital and for other general corporate purposes.

We thank our new and existing shareholders that participated in the offering.

Moving on, I wanted to highlight the completion of our accelerated capital improvement plan. In 2017, Global Water invested an additional $20.9 million of cash flow into the capital improvement program, bringing the three-year total to nearly $35 million. These expenditures represent investments that we expected to increase revenue, reduce our variable cost on a per unit basis and build our rate base. Importantly, these prudent capital improvements in our existing utilities enhance the level of service we provide to our customers and supports the growth of the communities we have the privilege to serve.

The facility improvements included in the accelerated cap ex plan were placed into service in the second quarter of 2018. From here, with these completions, we expect to return to a much lower pace of capital investment into our existing utilities, which will greatly benefit cash flow, allowing our free cash flow to be utilized for other growth initiatives.

Highlighting organic growth further, year-to-date, in 2018, we have achieved an annualized growth rate of 5.7%, confirming that new housing growth continues to accelerate in our service areas. Total connections growth stands at 7.8% when you include Turner Ranches. With the expectation to close on the two Class D utilities this year, it is possible we will realize a double-digit growth rate within 2018.

Metro-Phoenix single family permit data remains very strong. For Maricopa County and Pinal County combined, the Homebuilders Association of Central Arizona reported that single-family housing permits grew 12% to 19,863 units in 2017. Permits are forecasted by the Greater Phoenix Blue Chip to increase to nearly 24,000 permits in 2018 and to 27,000 permits in 2019.

In the City of Maricopa, where Global Water has its largest water and wastewater permitted utility service area, the Homebuilders Association of Central Arizona reports that permits are up 66% year-to-date over 2017.

Before turning the call over to Mike to review the second quarter 2018 financial performance in greater detail, I want to again lay out our primary objectives. Moving forward, Global Water will continue to meet our primary mandates to provide safe, reliable and sustainable service to customers and partners while taking a disciplined approach to growth and value creation through the following means: we will work to grow recurring EBITDA by driving top line revenue growth and creating operational efficiencies and managing controllable expenses; with the completion of the accelerated capital improvement plan in 2018, we will make only targeted capital improvements in our existing utilities as necessary; we will routinely analyze our dividend policies; and finally, we will pursue accretive acquisitions with consolidation benefits, even beyond the four transactions that have been previously announced, two of which have closed and two that are pending. Accretive tuck-ins such as this will complement the strong position in growth of our core regional assets and we are committed to continue to pursue similar opportunities, both big and small. I will now turn the call over to Mike.

Michael Liebman:

Thank you, Ron. Hello, everyone. Total revenues for the quarter were $10.8 million, which was up $2.7 million or 33.1% compared to Q2 2017. This increase is primarily driven by the $2.4 million of revenue we recognized under our infrastructure coordination and financing agreements, also known as ICFAs. A more fulsome explanation of ICFAs can be found in our quarterly and annual filings. However, just for some background, ICFAs are agreements we entered into with developers and homebuilders whereby Global Water provide 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 these ICFAs, we have a contractual obligation to ensure physical capacity exists through our regulated utilities for water and wastewater to the landowner or developer when needed. Because of the wastewater planned expansion and additional capacity added during Q2 2018, there were no additional

significant performance obligation under these ICFAs. Thus, we were able to recognize the $2.4 million of deferred revenue.

Regulated revenues for the quarter were up $307,000 or 3.8%, primarily due to a 5.2% organic connection growth, a 2.5% connection growth due to the acquisition of Turner Ranches and increased rates. I will point out, as Ron mentioned, that our Q2 2018 financials only reflect one month of Turner Ranches performance since we acquired them on May 30, 2018. These benefits to revenue were offset by a reduction to revenue as a result of the anticipated impact of tax reform. Specifically, we reduced revenue by $378,000 in Q2 of 2018 to reflect the anticipated impact of tax reform. I'll speak about tax reform in a little more detail later on. However, if you remove the reduction to revenue for anticipated impacts of tax reform, Q2 regulated revenues increased by $685,000 or 8.4% over 2017.

Year-to-date, total revenues through Q2 of 2018 were $18.3 million, which was up $3.3 million or 22.3% compared to the same period in 2017. As previously mentioned, this was primarily driven by the ICFA revenue recognized in Q2 2018. Regulated revenues year-to-date were up $946,000 or 6.3% due to strong organic connection growth, the Turner acquisition and increased rates, offset by the impacts of tax reform. If you remove the impacts of tax reform, year-to-date revenues increased $1.3 million or 8.9% compared to the same period in 2017.

Operating expenses in Q2 of 2018 were $6.7 million compared to $6.4 million in Q2 of 2017. This is an increase of $301,000 or 4.7%. Notable changes in operating expenses included increased operating and maintenance cost of $209,000. This increase was primarily driven by property taxes, utility expense, contract services and the additional cost associated with Turner Ranches. It's worth pointing out that all of these operating expense increases were driven by increases in our revenue growth. And we also had an increased depreciation expense by $81,000.

Year-to-date through Q2 of 2018, operating expenses were $12.8 million compared to $12.1 million prior year. This is an increase of $670,000 or 5.5% over prior year. Notable changes in operating expenses included increased operating and maintenance cost of $240,000. Again, this was primarily driven by property taxes, utility expense, contract services and cost associated with Turner Ranches.

We also had increased general and administrative cost of $198,000, which was primarily driven by higher professional fees associated with our acquisition initiatives.

Lastly, we had increased depreciation expense by $234,000, driven by all the capital investments made over the past year.

Now to discuss other expenses and income. Other expense for Q2 of 2018 was $1.1 million, which was an increase of $86,000 or 8.6% compared to Q2 of 2017. The increase was primarily due to the decrease in the Valencia earnout of $171,000, offset by a $78,000 decrease in other related party losses. Year-to-date through Q2 of 2018, other expense was $2 million, which was an increase of $247,000 or 14.2%, which was primarily attributed to a decrease in the Valencia earnout of $243,000. 2018's annualized growth rate in Valencia service territory is 3.7% compared to 6.5% in all of 2017.

Turning to net income. Global Water had net income in Q2 of 2018 of $2.3 million or $0.11 per share compared to $425,000 or $0.02 per share in Q2 of 2017. Year-to-date net income was $2.6 million or $0.13 per share compared to $614,000 or $0.03 per share.

Adjusted EBITDA, which adjusts for nonrecurring events, such as ICFA revenue and also adjust for option expense in our equity investment in FATHOM, was $4 million in Q2 of 2018, which is down $34,000 or 0.9% compared to Q2 of 2017. Adjusted EBITDA was relatively flat due to the reduction in revenue associated with tax reform, coupled with a decrease in the Valencia earnout and the increase in

professional fees. Partially offsetting all this was an increase in revenue due to organic connection growth, the acquisition of Turner Ranches and increased rates.

If you exclude the anticipated impact of tax reform, Adjusted EBITDA was up $344,000 or 8.6%. Year-to-date Adjusted EBITDA was $7.7 million, which reflects an increase of $423,000 or 5.9%. If you exclude the impacts of tax reform, year-to-date Adjusted EBITDA was $8 million, which reflects an increase of $801,000 or 11.1%.

Before turning the call back to Ron, I just wanted to provide some background on tax reform with respect to the reduction of revenues we have taken. On August 3, 2018, the Arizona Corporation Commission staff proposed to the commission that Global's revenue reduction align with the phase in of revenue approved at our last rate case. Pursuant to our last rate case, Global will have phased in approximately 71% of its total revenue, and therefore, staff proposes we reduce revenue by 71% of the $1.1 million total tax reduction. While the commissioners still have to evaluate and vote on the tax reform treatment to Global Water, we felt it was more likely than not that the commission would approve this proposal.

As a result, we reduced revenue by $378,000 in Q2 of 2018, which reflects one half of the proposed total reduction for 2018 of approximately $756,000. We expect the commission to vote on this issue sometime in August or September of this year. However, assuming the commission support staff's proposal, the remaining $378,000 of additional reductions to revenue will be taken in Q3 and Q4 of 2018 for approximately $189,000 in each quarter. This concludes our update on Q2 2018 results. I'll now pass the call back to Ron.

Ron Fleming:

Thank you, Mike. It is clear, despite the revenue reductions caused by the federal tax reform and corporate rate reductions, Global Water is a high-growth utility Company and this is accelerating on multiple fronts. We intend to remain at the forefront of the water Management industry and advance our mission of achieving efficient growth and consolidation. We truly believe that expanding our platform and applying our expertise throughout our regional service areas and to new utilities will be beneficial to all stakeholders involved. We appreciate your investment in and support of us as we grow Global Water to address important utility water resource and economic development issues in Arizona and potentially beyond. Those highlights conclude our prepared remarks. Thank you. Mike and I are now available to answer your questions.

Operator:

Thank you. We will now begin the question-and-answer session. To join the question queue, you may press star, then one on your telephone keypad. You will hear a tone acknowledging your request. If you're using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star, then two. We will pause for a moment as callers join the queue.

Our first question comes from Gerry Sweeney with Roth Capital. Please go ahead.

Gerard Sweeney:

Hey, good morning, Ron and Mike. Thanks for taking my question.

Michael Liebman:

Yes. Good morning, Gerry.

Gerard Sweeney:

This is a little bit of a follow-up on tax reform. I think I got most of it. In this quarter, you—you've reduced revenue by $378,000 and then will be about $180,000 for the next two quarters. But for the next couple of years, I think you have to get to $1.1 million. Is that about $100,000 of reduction in revenue per year till we get to that $1.1 million, is that how it's going to work?

Michael Liebman:

Yes, Gerry, this is Mike. That's exactly the way to think about it. Of the $1.1 million, roughly $800,000 of it will be in 2018, and then an additional $100,000 in the three years following.

Gerard Sweeney:

In the three years following, just for modeling purposes, about $25,000 per quarter, essentially?

Michael Liebman:

That's right.

Gerard Sweeney:

Okay. Then at the end of the day, this is almost pure profit coming out so it's a little bit of a hit near term with EBITDA, but with connection growth, the Class D water and wastewater systems coming on, we should be able to close it pretty quickly is my thought. Is that a fair approach?

Michael Liebman:

That is, obviously, with Turner Ranches, we only had one quarter in this—one month in this quarter, plus so you'll see—and then in addition to that, just point out that the tax reform, even though it's a hit to top line revenue and EBITDA, it is earnings neutral at the end of the day.

Gerard Sweeney:

That's right. That's a good point. Thanks. Then just another...

Ron Fleming:

Gerry, if I could. The other way I would think about that is we still have four more years of rate phase ins from our last rate case and that's why we hadn’t passed that, that line into the phase in, and so that number is actually $1.4 million over that same period so if—and really, that was happening at about 1.5% increase per year to top line revenue. Tax reform really is just going to eliminate those marginal 1% increases over the next four years. They kind of wash out, but that doesn't affect all the other organic growth and all the other acquisition growth.

Gerard Sweeney:

Got it. It's another fair point, too. Maybe just two other sort of ancillary questions. Just curious Valencia, that was on a tear for a while, not growing as quickly. Any thoughts as to what's slowing that down, especially with the whole region is growing?

Ron Fleming:

Yes. Fair enough. It is interesting in that last year, the city of Buckeye where the prior utility we owned is located, Valencia, it made the top 10 fastest growing municipalities list nationally, and so we saw that 7-plus percent. They're still growing well, they're just—it seems that more of that growth is outside of that territory of our prior utility. We don't have visibility into that utility anymore, so it's hard to be—give specifics about what may be going on there. But I will say that long term, the City of Buckeye, which is somewhat equivalent on the other side of Metro-Phoenix, to the City of Maricopa, is similarly situated along the growth corridor, it's got a lot of room to grow, and so we believe that over the long term, cities ebb in and out little bit, but we think that, that tail is going to continue to pay off nicely and that city will see high growth and more of that growth will happen to occur inside of that prior service area where we—on the earnout rates. It's down a little bit this year, but we still feel pretty good about what that means to us long term.

Gerard Sweeney:

Okay, fair enough. I mean, it's obviously a nice little bonus there in the income statement, so it's always nice to see. But anyhow, congratulations on a great quarter and a great time so I appreciate your time. Thank you.

Ron Fleming:

Thanks, Gerry.

Operator:

This concludes the question-and-answer session. I would like to turn the conference back over to Ron Fleming for any closing remarks.

Ron Fleming:

Thank you, Operator. I would just like to thank everyone for participating in this call and for your continued interest in GWRS and Global Water. Thanks, and we appreciate it. Look forward to speaking with you again soon.

Operator:

This concludes today's conference call. You may disconnect your lines. Thank you for participating, and have a pleasant day.