Global Water Resources, Inc.

Fourth Quarter and Full Year 2018 Conference Call

March 7, 2019
CORPORATE PARTICIPANTS

Heather Krupa, Controller

Ron L. Fleming, President and Chief Executive Officer

Mike Liebman, Senior Vice President and Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Gerard Sweeney, ROTH Capital Partners, LLC

PRESENTATION

Operator:

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the Global Water Resources, Inc. Fourth Quarter and Full Year 2018 Conference Call. At this time, all participants are in a 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 March 7, 2019, at 1:00 p.m. Eastern time.

I would now like to turn the conference over to Heather Krupa, Controller. Please go ahead.

Heather Krupa:

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

Speaking today is Ron Fleming, Chairman, 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 year ended December 31, 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 information presented today may include forward-looking statements. These forward-looking statements involve 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 reflects Management’s views as of the date hereof, and are not guarantees of future performance.
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For additional information regarding the factors that may affect future results, please read the sections Risk Factors and Management’s Discussion and Analysis of Financial Condition and Results of Operation included within our latest Form 10-K 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 earnings release, which is available on our website. Unless otherwise stated, all amounts discussed are in U.S. dollars.

I will now turn the call over to Mr. Ron Fleming.

Ron L. Fleming:

Thank you, Heather. Good morning, everyone, and thank you for joining us today. We are very pleased to report our fourth quarter and full year 2018 results. 2018 was an exciting year for Global Water, with the company achieving successful result throughout our business, including with compliance and safety, organic growth and acquisition, and completion of many significant improvement projects within the communities we serve.

First and foremost, our employees successfully completed the year with no recordable safety event incident and no environmental compliance violation. We have now achieved over 564 consecutive days without a recordable safety accident and over 1,061 days without an environmental compliance violation. These remarkable achievements show the dedication and care of our employees as we provide exceptional performance in the delivery of safe and reliable utility service.

Additionally, Global Water was named finalist in 2018 Environmental Excellence Awards by Arizona Forward for our effective implementation of Total Water Management. We appreciate the recognition of our dedication to managing scarce water resources for the benefit of the communities we serve.

Turning to financial performance, revenues for the year increased 13.8% to $35.5 million, up from $31.2 million, driven primarily by a $2.5 million recognition of revenue under the infrastructure, coordination, and financing agreements as a result of the completion of capital improvements that increased the capacity of our Palo Verde Utilities wastewater reclamation facility. The increase in revenue was also due to growth in active connections of 12% and approved rate increases, partially offset by reductions due to tax reform. This 12% connection growth rate consists of 5.2% organic growth and acquisition.

Acquisitions completed in 2018 included Global Water - Turner Ranches Irrigation; a non-potable irrigation water utility in Mesa, Arizona; and Global Water - Red Rock Utilities, a water and wastewater utility with service areas in Pinal and Pima counties of Arizona.

Turner added 963 connections and approximately 7 square miles of service area. Red Rock added more than 1,735 connections and approximately 9 square miles of service area. Our staff has already applied their operational and technical expertise in on-boarding Turner and Red Rock, improving efficiency and reliability of these utilities to better serve our customers.

In July, we completed an equity raise with net proceeds of $14.6 million. The proceeds are being used to fund acquisitions and for working capital and other general corporate purposes. Additionally, the company secured a two-year revolving line of credit of up to $8 million to support the company's growth initiative. This line remains unused as of today.

The company received an extension from the IRS until the end of 2019 to defer the remaining gain realized from the disposition of Valencia Water Company. With the currently planned capital improvement projects for 2019, we expect to have fully deferred the remaining gain by end of year 2019.
Finally, we have had the opportunity to add fresh perspective to our Board of Directors with the addition of Debra Coy, a national and international water industry expert; Brett Huckelbridge, a capital markets and fund manager expert; and most recently, David Rousseau, President of the combined largest wholesale water and power entity in the State of Arizona. Combined with my new role as Chairman and the designation of Dave Tedesco as Lead Independent Director, we believe the talents of our directors will support the next phase of our mission to be a leader in customer service and water resource management as we continue to grow.

Moving on from these accomplishments, I wanted to highlight organic growth further. For 2018, single-family dwelling permits in Maricopa and Pinal counties were up to 22,437 units or 13% over 2017, which was 12% over 2016 units. The forecast remains strong for 2019 projected to see approximately 27,000 single-family dwelling permits.

Importantly, the data for the City of Maricopa submarket continues to be very strong. As a reminder, in 2017 we realized a 59% increase over 2016 with a total of 865 single-family dwelling permits being issued that year. That was enough to be the largest year-over-year increase of any submarket in Metro Phoenix. In 2018, permit growth is up another 18% over 2017 with 1,022 permits issued. This acceleration supports our long-stated position that as sustained growth continues in Metro Phoenix, we will get a larger market share of new homes based on the amount of lot and infrastructure capacity that exists.

Before turning the call over to Mike to review the year-end 2018 financial performance in greater detail, I want to again lay out our primary objectives. Global Water will continue to meet our primary mandate to provide safe, reliable and sustainable service to our customers and partners, which is our primary charge, and is our mandate because it is critical to successfully managing growth and long-term value creation. Then, we will take a disciplined approach to grow reoccurring EBITDA by driving top-line revenue growth, and while creating operational efficiencies and managing controllable expenses. Hitting pre-established financial budgets and operating as an efficient utility benefits both our rate payers and our shareholders. We will make further capital improvements into the communities we serve as necessary, and we will routinely analyze our dividend policy as we go.

Finally, we will pursue acquisitions with consolidation benefits. Consolidation will complement the strong position and growth of our core regional assets and we are committed to continue to pursue similar opportunities, both big and small. As proven by our recent acquisitions, this consolidation can help improve our industry as a whole and provide many benefits to the customers and communities we have the privilege to serve.

I will now turn the call over to Mike.

Mike Liebman:

Thank you, Ron. Hello, everyone. Total revenues for the year were $35.5 million, which was up $4.3 million, or 13.8%, compared to 2017. This increase is primarily driven by the $2.5 million of ICFA revenue recognized, 5.2% organic connection growth, and acquisition connection growth of 2.5% and 4.3% from Turner Ranches and Red Rock, respectively. These benefits were offset by a reduction to revenue as a result of tax reform. Specifically, we reduced revenue by $790,000 in 2018 to reflect the impact of tax reform. However, if you remove the reduction to revenue from the impact of tax reform and the increase to revenue from ICFA revenues, revenue increased by $2.6 million or 8.3%.

Operating expenses in 2018 were $26.2 million compared to $23.9 million in 2017. This is an increase of $2.4 million, or 10%. Notable changes in operating expenses included increased operating and maintenance cost of $680,000. This increase was primarily driven by the additional costs associated with the Turner Ranches and Red Rock acquisitions of $286,000, as well as an increase in expenses such as utilities, property taxes, contract services, which all increase as revenue increases.
Secondly, we had increased general and administrative costs of $1.1 million. This increase was primarily driven by an increase in professional fees, deferred compensation, and personnel expense.

And lastly, we had increased depreciation expense by $561,000 due to an increase in fixed assets associated with our capital expenditures plan, as well as the added depreciation associated with the acquisitions of Red Rock and Turner Ranches.

Now to discuss other expense. Other expense for 2018 was $4.4 million, which was an increase of $990,000 compared to 2017. This increase was primarily due to a decrease in the Valencia earn-out of $890,000. 2018’s growth rate in Valencia’s service territory was 2.3% in 2018 compared to 6.5% in 2017.

Turning to net income, Global Water had net income in 2018 of $3.1 million, or $0.15 per share, compared to $4.6 million, or $0.23 per share, in 2017. Adjusted EBITDA, which adjusts for nonrecurring events such as ICFA revenue and also adjusts for option expense and our equity investment in FATHOM, was $15.6 million in 2018, which is down $755,000, or 4.6%, compared to 2017.

Adjusted EBITDA was down primarily due to the impacts of tax reform of $790,000 and the lost income from the Valencia earn-out of $890,000. These reductions were offset by increases in organic growth of 5.2%, as well as the acquisition growth from Red Rock and Turner Ranches.

This concludes our update on 2018 results. I'll now pass the call back to Ron.

Ron L. Fleming:

Thank you, Mike. It is clear, excluding the revenue reductions caused by federal tax reform and the corresponding corporate rate reductions and the slowdown over Valencia earn-out, both of which are beyond our control, Global Water's top-line and connection growth rates continue to be very strong.

As we handle this growth, we intend to remain at the forefront of the water management industry and advance our mission of achieving efficiency 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.

These highlights conclude our prepared remarks. Thank you. Mike and I are now available to answer any questions.

Operator:

Certainly. We will now begin the question-and-answer session. To join the question queue, you may press star, 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, two. We will pause for a moment as callers join the queue. Once again, to ask a question please press star, one at this time.

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

Gerard Sweeney:

Good morning, Ron and Mike. Thanks for taking my call.

Ron L. Fleming:


Good morning, Gerry.

Mike Liebman:

Hey, Gerry.

Gerry Sweeney:

Question on permits. A lot of talk in the media about slowing housing permits that are—this is obviously on a national basis; as they say, all real estate is local but—and Maricopa had some great growth the last two years and I pulled some permit activity in January and February. Definitely strong, maybe not as strong as one or two of the years in the past, but I also know there’s a bunch of infrastructure work that’s going in the city with I think the bridge over the railroad track, as well as some state routes. I forget the exact number, but planning around that, maybe widening it, et cetera. Any comment on that, and just maybe how that could position Global Water for the next several years?

Ron L. Fleming:

Yes, Jerry, you’re right. I think it is local and, certainly when it comes to Maricopa, that’s the way I think everybody needs to look at it. Arizona overall is doing quite well still, and, in fact, Maricopa County was the fastest growing county in the U.S., so the more regional numbers look good. Now, if you zoom into Maricopa, and to further expand on some of the points you made there, there’s been nearly $10 billion of investment within a 10-mile radius of the City of Maricopa and that’s not—obviously well beyond what we’re doing there in the city itself. It’s the fact that Intel continues to expand their manufacturing facility that’s located up the road in Chandler. Major corporation campuses are also being located in and around that Intel area in Southern Chandler.

The ADOT, or the Arizona Department of Transportation, is finishing a very significant transportation freeway project that’s going to connect the west valley of Phoenix around what’s called South Mountain, so you don’t have to go through Metro Phoenix anymore to get to North Pinal County, the City of Maricopa, and this area in Chandler that I’m referring to. And that project, which adds really three lanes of traffic in both directions, is expected to be completed in the next 12 months. Then you got things more local to Maricopa which, as you say, there’s a major overpass being constructed over some rail yards that run through the center of the city today. And fortunately, which is a nice asset for the City of Maricopa, there is a Native American community located next to Maricopa that just did a $200 million resort and casino expansion and then you got the $40 million we put in that city over the last couple years. So, there is a lot of investment going on in that basically regional area and that’s because of the long-term belief that everybody has in there. It’s just the growth patterns of Phoenix push out through South Chandler and Gilbert down to North Pinal County where we’ve got these major interests.

So, for all of those reasons, we’re very bullish on the long-term potential of the area. We do think even though January and February saw a bit of a decline in permits issued, even that decline still keeps our growth rate at near 4%, which is four times the national average for utility growth rate. So, all is good on that front and we hope it’s long and sustained.

Gerry Sweeney:

Great. That’s it for me. I appreciate it. Thank you.

Operator:

Once again, if you have a question, please press star, one. We will pause for another moment for any other questions. This concludes the question-and-answer session. I would like to turn the conference back over to Ron L. Fleming for any closing remarks.
Ron L Fleming:

Thank you, Operator. I would just like to thank everyone for participating in our call today and for your ongoing interest in Global Water. Thanks, and we look forward to speaking with you again.

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