
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2017

OR

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

For the transition period from _____ to _____

Commission File Number: 001-37756

Global Water Resources, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

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

85027
(Zip Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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. (Check one):

Large accelerated filer	☐	Accelerated filer	☒
Non-accelerated filer	☐ (Do not check if a smaller reporting company)	Smaller reporting company	☐
		Emerging growth company	☒

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

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

As of May 10, 2017, the registrant had 19,581,266 shares of common stock, \$0.01 par value per share, outstanding.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements.

GLOBAL WATER RESOURCES, INC. CONDENSED CONSOLIDATED BALANCE SHEETS (in thousands, except share and per share amounts) (Unaudited)

	March 31, 2017	December 31, 2016
ASSETS		
PROPERTY, PLANT AND EQUIPMENT:		
Property, plant and equipment	\$ 281,428	\$ 273,366
Less accumulated depreciation	(74,079)	(72,877)
Net property, plant and equipment	207,349	200,489
CURRENT ASSETS:		
Cash and cash equivalents	14,807	20,498
Accounts receivable — net	1,328	1,471
Due from affiliates	444	333
Accrued revenue	1,631	1,619
Prepaid expenses and other current assets	796	819
Total current assets	19,006	24,740
OTHER ASSETS:		
Intangible assets — net	12,772	12,772
Regulatory asset	81	110
Deposits	5	—
Bond service fund and other restricted cash	230	228
Equity method investment	602	480
Total other assets	13,690	13,590
TOTAL ASSETS	\$ 240,045	\$ 238,819
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 3,039	\$ 1,791
Accrued expenses	8,462	7,602
Deferred revenue	8	1
Customer and meter deposits	1,406	1,482
Long-term debt and capital leases — current portion	7	25
Total current liabilities	12,922	10,901
NONCURRENT LIABILITIES:		
Long-term debt and capital leases	114,280	114,317
Deferred regulatory gain - ICFA	19,739	19,740
Regulatory liability	7,859	7,859
Advances in aid of construction	62,232	61,996
Contributions in aid of construction — net	4,506	4,585
Deferred income tax liabilities, net	2,440	2,383
Acquisition liability	934	934
Other noncurrent liabilities	896	913
Total noncurrent liabilities	212,886	212,727
Total liabilities	225,808	223,628
Commitments and contingencies (see Note 13)		
SHAREHOLDERS' EQUITY:		
Common stock, \$0.01 par value, 60,000,000 shares authorized; 19,581,266 shares issued as of March 31, 2017 and December 31, 2016	196	196
Paid in capital	18,506	19,510
Accumulated deficit	(4,465)	(4,515)
Total shareholders' equity	14,237	15,191
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 240,045	\$ 238,819

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 March 31,	
	2017	2016
REVENUES:		
Water services	\$ 2,785	\$ 2,989
Wastewater and recycled water services	3,988	3,807
Unregulated revenues	18	20
Total revenues	6,791	6,816
OPERATING EXPENSES:		
Operations and maintenance	1,474	1,612
Operations and maintenance - related party	360	472
General and administrative	2,432	2,054
Depreciation	1,646	1,617
Total operating expenses	5,912	5,755
OPERATING INCOME	879	1,061
OTHER INCOME (EXPENSE):		
Interest income	4	3
Interest expense	(1,312)	(1,822)
Other	352	323
Other - related party	214	(101)
Total other income (expense)	(742)	(1,597)
INCOME (LOSS) BEFORE INCOME TAXES	137	(536)
INCOME TAX (EXPENSE) BENEFIT	(87)	222
NET INCOME (LOSS)	\$ 50	\$ (314)
Basic earnings (loss) per common share	\$ 0.00	\$ (0.02)
Diluted earnings (loss) per common share	\$ 0.00	\$ (0.02)
Dividends declared per common share	\$ 0.07	\$ 0.07
Weighted average number of common shares used in the determination of:		
Basic	19,581,266	18,241,746
Diluted	19,622,751	18,241,746

See accompanying notes to the condensed consolidated financial statements

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

	Shares	Common Stock	Paid-in Capital	Accumulated Deficit	Total Equity
BALANCE – December 31, 2016	<u>19,581,266</u>	<u>\$ 196</u>	<u>\$ 19,510</u>	<u>\$ (4,515)</u>	<u>\$ 15,191</u>
Dividend declared \$0.07 per share	—	—	(1,322)	—	(1,322)
Merger of GWRC	—	—	53	—	53
Stock compensation	—	—	265	—	265
Net income	—	—	—	50	50
BALANCE – March 31, 2017	<u>19,581,266</u>	<u>\$ 196</u>	<u>\$ 18,506</u>	<u>\$ (4,465)</u>	<u>\$ 14,237</u>

See accompanying notes to the condensed consolidated financial statements

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

	Three Months Ended March 31,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 50	\$ (314)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Deferred compensation	425	214
Depreciation	1,646	1,617
Amortization of deferred debt issuance costs and discounts	11	45
(Gain) loss on equity investment	(122)	188
Other (gains) and losses	4	—
Provision for doubtful accounts receivable	21	22
Deferred income tax benefit (expense)	57	(339)
Changes in assets and liabilities:		
Accounts receivables	122	(85)
Other current assets	(100)	(1,382)
Accounts payable and other current liabilities	(12)	2,432
Other noncurrent assets	27	29
Other noncurrent liabilities	(30)	9
Net cash provided by operating activities	<u>2,099</u>	<u>2,436</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(6,505)	(1,371)
Deposits of restricted cash, net	(2)	(9)
Other cash flows from investing activities	(5)	—
Net cash used in investing activities	<u>(6,512)</u>	<u>(1,380)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments under capital lease	(67)	(36)
Debt issuance costs paid	—	(8)
Advances in aid of construction	111	53
Dividends paid	(1,322)	(1,160)
Net cash used in financing activities	<u>(1,278)</u>	<u>(1,151)</u>
DECREASE IN CASH AND CASH EQUIVALENTS	(5,691)	(95)
CASH AND CASH EQUIVALENTS — Beginning of period	20,498	11,513
CASH AND CASH EQUIVALENTS — End of period	<u>\$ 14,807</u>	<u>\$ 11,418</u>

See accompanying notes to the condensed consolidated financial statements

GLOBAL WATER RESOURCES, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited)

1. INTERIM FINANCIAL STATEMENTS

Basis of Presentation and Principles of Consolidation – The condensed consolidated financial statements of Global Water Resources, Inc. (the “Company”, “GWRI”, “we”, “us”, or “our”) and related disclosures as of March 31, 2017 and for the three months ended March 31, 2017 are unaudited. The December 31, 2016 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, 2016. In our opinion, these financial statements include all normal and recurring adjustments necessary for the fair statement of the results for the interim period. The results of operations for the three months ended March 31, 2017 are not necessarily indicative of the results to be expected for the full year, due to the seasonality of our business.

The Company prepares its financial statements in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”). The preparation of the financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. The U.S. dollar is the Company’s reporting currency and functional currency.

As a company with less than \$1.0 billion in revenue during our last fiscal year, the Company qualifies as an “emerging growth company”, as defined in the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”), under the rules and regulations of the SEC. An emerging growth company may take advantage of specified reduced reporting and other requirements that are otherwise applicable generally to public companies. The Company elected to take advantage of these provisions for up to five years or such earlier time that the Company is no longer an emerging growth company. The Company has elected to take advantage of some of the reduced disclosure obligations regarding financial statements. Also, as an emerging growth company the Company can elect to delay adopting new or revised accounting standards issued subsequent to the enactment of the JOBS Act until such time as those standards apply to private companies. The Company has chosen to take advantage of this extended accounting transition provision.

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

Sale of Willow Water Valley Co., Inc. — On March 23, 2015, the Company reached an agreement to sell the operations and assets of Willow Valley Water Company, Inc. (“Willow Valley”) to EPCOR. EPCOR purchased the operations, assets, and rights used by Willow Valley to operate the utility system for \$2.3 million. The transaction was approved by the Arizona Corporation Commission (“ACC”) on March 10, 2016, and the transaction closed on May 9, 2016.

Per ASC 360-10-45-9, *Impairment and Disposal of Long-Lived Assets*, the assets and liabilities of Willow Valley were determined to meet the criteria to be classified as held for sale beginning with our March 31, 2015 consolidated financial statements. The criteria utilized to make this determination were: (i) management had the authority and had entered into an agreement to sell the assets of Willow Valley; (ii) the assets and liabilities were available for immediate sale in their present condition; (iii) the approval from the ACC was probable within the next year; (iv) a reasonable price had been agreed upon; and

(v) it was unlikely that significant changes to the agreement would occur prior to approval. In consideration of ASC 205-20-45-1, the Willow Valley transaction did not meet the criteria for discontinued operations as the transaction did not change the services provided nor the manner in which the Company operates. Therefore, it was determined the transaction did not represent a strategic shift. A loss of \$54,000 was recognized upon close of the sale of Willow Valley in the second quarter of 2016.

Merger of GWR Global Water Resources Corp. (“GWRC”) — On May 3, 2016, the Company completed the merger of GWRC into GWRI. At the time of the merger, GWRC ceased to exist as a British Columbia corporation and the Company continued as the surviving entity of the merger. See Note 7 – “Transactions with Related Parties”. In conjunction with the merger of GWRC into GWRI, the Company recorded \$731,000 in accounts payable and \$353,000 in deferred compensation on the books of GWRI that were previously recorded at GWRC. In addition to these liabilities, the Company also recorded an approximate \$1.4 million tax liability associated with the transfer of GWRC from Canada to the United States. A corresponding reduction in paid in capital was recorded with the merging of these liabilities into GWRI. The 8,726,747 outstanding common shares of the Company held by GWRC, and acquired by the Company at the time of merger, were recorded as treasury stock and were retired in December 2016.

Initial Public Offering — On April 27, 2016, the SEC declared effective the registration statement relating to the public offering of our common stock. On May 3, 2016, the Company completed the initial public offering of 1,164,800 shares of common stock at \$6.25 per share for gross proceeds of approximately \$7.3 million (the “U.S. IPO”). The Company granted the underwriter the option to purchase up to an additional 174,720 shares of common stock at the same price, which was exercised by the underwriter on May 11, 2016, for additional gross proceeds of \$1.1 million. Our shares of common stock are listed on the NASDAQ Global Market and the Toronto Stock Exchange under the symbols “GWRS” and “GWR”, respectively.

Sonoran Acquisition Liability — On March 17, 2016, the Company entered into an agreement with Sonoran Utility Services, LLC (“Sonoran”) to amend certain provisions of the purchase and sale agreement related to the acquisition of Sonoran’s assets on June 15, 2005. The amended agreement allowed the Company to reduce its original \$3.8 million acquisition liability due to Sonoran by approximately \$1.0 million to \$2.8 million, if the Company settled the amount due within ten days of the closing of the note purchase agreement (“Note Purchase Agreement”). The Note Purchase Agreement closed on June 24, 2016 and the Sonoran liability was subsequently settled in June 2016. Upon settlement of the Sonoran acquisition liability, the Company recorded a gain of \$954,000 in other income.

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

Pursuant to Internal Revenue Code §1033, the Company may defer the gain on condemnation through the end of the year 2017. On April 18, 2017, the Company filed a request for a one-year extension to defer the gain to the end of 2018. As the extension has not been approved, the Company has identified certain currently planned investments within our capital improvement plan, which we have accelerated with a 2017 timeframe in mind. As a result, we expect capital expenditures to increase in 2017 as compared to recent years, with corresponding reductions to occur in 2018, 2019, and 2020.

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standard Update (“ASU”) 2014-09, *Revenue from Contracts with Customers* (“ASU 2014-09”), which completes the joint effort between the FASB and International Accounting Standards Board to converge the recognition of revenue between the two boards. The new standard affects any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets not included within other FASB standards. The guiding principal of the new standard is that an entity should recognize revenue in an amount that reflects the consideration to which an entity expects to be entitled for the delivery of goods and services. ASU 2014-09 may be adopted using either of two acceptable methods: (1) retrospective adoption to each prior period presented with the option to elect certain practical expedients; or (2) adoption with the cumulative effect recognized at the date of initial application and providing certain disclosures. To assess at which time revenue should be recognized, an entity should use the following steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation. For public business entities, ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within the reporting period. For private companies, ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2018 and interim reporting periods beginning after December 15, 2019. Earlier application is allowed in certain circumstances. The Company does not

believe this update will have an effect on the Company's regulated revenue. However, the Company is evaluating the effect of the new standard on the accounting for contributions in aid of construction ("CIAC"), which may change if CIAC is determined to be revenue from customers.

In May 2016, the FASB issued ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients* ("ASU 2016-12"), to address narrow-scope improvements to the guidance on collectability, noncash consideration, and completed contracts at transition. The amendment also provides a practical expedient for contract modifications at transition and an accounting policy election related to the presentation of sales taxes and other similar taxes collected from customers and are expected to reduce the judgment necessary to comply with Topic 606. For public business entities, ASU 2016-12 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within the reporting period. For private companies, ASU 2016-12 is effective for annual reporting periods beginning after December 15, 2018 and interim reporting periods beginning after December 15, 2019. Earlier application is allowed in certain circumstances. The Company does not believe this update will have an effect on the Company's regulated revenue.

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

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

In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing* ("ASU 2016-10"), to clarify two aspects of Topic 606: (1) identifying performance obligations; and (2) the licensing implementation guidance. The amendments do not change the core principle of the guidance in Topic 606. For public business entities, ASU 2016-10 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within the reporting period. For private companies, ASU 2016-10 is effective for annual reporting periods beginning after December 15, 2018 and interim reporting periods beginning after December 15, 2019. Earlier application is allowed in certain circumstances. The Company does not believe this update will have an effect on the Company's regulated revenue.

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

In October 2016, the FASB issued ASU 2016-16, *Income Taxes (Topic 740) Intra-Entity Transfers of Assets Other Than Inventory* ("ASU 2016-16"). ASU 2016-16 instructs entities to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs and (compared to current U.S. GAAP which prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party). The guidance is effective for public companies for annual periods beginning after December 15, 2017 and interim periods within those annual periods. For all other entities, the guidance is effective for annual periods beginning after December 15, 2018 and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted. The guidance is required to be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the

beginning of the period of adoption. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements.

In October 2016, the FASB issued ASU 2016-17, *Consolidated (Topic 810): Interests Held through Related Parties That Are under Common Control* (“ASU 2016-17”). ASU 2016-17 amends how an entity that is a single decision-maker of a variable-interest entity (“VIE”) treats certain indirect interests in the VIE when determining whether the entity is the primary beneficiary of that VIE. Under the amended guidance, an entity is no longer required to consider indirect interests held through related parties that are under common control with the entity as the equivalent of direct interests in their entirety, but should instead include these interests on a proportionate basis, consistent with indirect interests held through other related parties. This guidance is effective for public companies for annual periods beginning after December 15, 2016, including interim periods within those annual periods. For all other entities, the amendments are effective for annual periods beginning after December 15, 2016 and for interim periods in annual periods beginning after December 15, 2017. The adoption of this accounting standard did not have a material effect on the Company’s consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)* (“ASU2016-18”). ASU 2016-18 requires amounts generally described as restricted cash and restricted cash equivalents to be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. The guidance is effective for public companies for annual periods beginning after December 15, 2017, and interim periods within those annual periods. For all other entities, the guidance is effective for annual periods beginning after December 15, 2018 and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted, including adoption in an interim period. The guidance should be applied using a retrospective transition method for each period presented. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements.

In December 2016, the FASB issued ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers* (“ASU 2016-20”). The ASU 2016-20 amendments allow entities not to make quantitative disclosures about remaining performance obligations in certain cases and require entities that use any of the new or previously existing optional exemptions to expand their qualitative disclosures. The amendment also clarifies narrow aspects of ASC 606 or corrects unintended application of the guidance. The effective date and transition requirements for ASU 2016-20 are the same as the effective date and transition requirements for ASU 2014-09. The Company does not believe this update will have an effect on the Company’s regulated revenue.

In January 2017, the FASB issued ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business* (“ASU 2017-01”). ASU 2017-01 provides a more robust framework to use in determining when a set of assets and activities is a business. Also the amendments provide more consistency in applying the guidance, reducing the costs of application, and make the definition of a business more operable. The guidance is effective for public companies for annual periods beginning after December 15, 2017, including interim periods within those periods. For all other entities, the guidance is effective for annual periods beginning after December 15, 2018, and interim periods with annual periods beginning after December 15, 2019. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements.

2. REGULATORY DECISION AND RELATED ACCOUNTING AND POLICY CHANGES

Our regulated utilities and certain other balances are subject to regulation by the ACC and meet the requirements for regulatory accounting found within ASC Topic 980, *Regulated Operations*.

In accordance with ASC Topic 980, rates charged to utility customers are intended to recover the costs of the provision of service plus a reasonable return in the same period. Changes to the rates are made through formal rate applications with the ACC, which we have done for all of our operating utilities and which are described below.

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

- For the Company's utilities, adjusting for the condemnation of the operations and assets of Valencia Water Company and sale of Willow Valley, 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):

	<u>Incremental</u>	<u>Cumulative</u>
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 contributions in aid of construction ("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 ICFAs. Existing ICFAs will remain in place, but a portion of future payments to be received under the ICFAs will be considered as hook-up fees, which are accounted for as CIAC once expended on plant.
- A 9.5% return on common equity was adopted.
- None of the Company's utilities will file another rate application before May 31, 2016. GWRI's subsidiaries, Global Water - Santa Cruz Water Company ("Santa Cruz") and Global Water - Palo Verde Utilities Company ("Palo Verde"), may not file for another rate increase before May 31, 2017.

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

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

Under the ICFAs, GWRI has a contractual obligation to ensure physical capacity exists through its regulated utilities for water and wastewater to the landowner/developer when needed. This obligation persists regardless of connection growth. Fees for these services are typically a negotiated amount per equivalent dwelling unit for the specified development or portion of land. Payments are generally due in installments, with a portion due upon signing of the agreement, a portion due upon completion of certain milestones, and the final payment due upon final plat approval or sale of the subdivision. The payments are non-refundable. The agreements are generally recorded against the land and must be assumed in the event of a sale or transfer of the land. The regional planning and coordination of the infrastructure in the various service areas has been an important part of GWRI's business model.

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

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

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

The Company will account for the portion allocated to the HUF as a CIAC contribution. However, in accordance with the ACC directives the CIAC is not deducted from rate base until the HUF funds are expended for utility plant. Such funds will be segregated in a separate bank account and used for plant. A HUF liability will be established and will be amortized as a reduction of depreciation expense over the useful life of the related plant once the HUF funds are utilized for the construction of plant. For facilities required under a HUF or ICFA, the utilities must first use the HUF moneys received, after which, it may use debt or equity financing for the remainder of construction. The Company will record 30% of the funds received, up until the HUF liability is fully funded, as deferred revenue, which is to be recognized as revenue once the obligations specified within the ICFA are met. As of March 31, 2017 and December 31, 2016, ICFA deferred revenue recorded on the consolidated balance sheet totaled \$19.7 million, which represents deferred revenue recorded for ICFA funds received on contracts that had become due prior to Rate Decision No. 74364. For ICFA contracts coming due after December 31, 2013, as funding is received 30% will be added to this balance with the remaining 70% recorded to a HUF liability, until the HUF liability is fully funded at which time any funding greater than the HUF liability will be recorded as deferred revenue.

Regulatory asset – Under ASC Topic 980, rate regulated entities defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that these costs and credits will be recognized in the rate making process in a period different from the period in which they would have been reflected in income by an unregulated company. Certain costs associated with our rate cases have been deferred on our balance sheet as regulatory assets as approved by the ACC. At March 31, 2017 and December 31, 2016, the Company had one regulatory asset in the amount of \$81,000 and \$110,000, respectively, related to costs incurred in connection with our most recent rate case. This amount began to amortize in January 2015, and will amortize over a three-year period.

Intangible assets / Regulatory liability – The Company previously recorded certain intangible assets related to ICFA contracts obtained in connection with our Santa Cruz, Palo Verde, and Sonoran acquisitions. The intangible assets represented the benefits to be received over time by virtue of having those contracts. Prior to January 1, 2010, the ICFA-related intangibles were amortized when ICFA funds were recognized as revenue. Effective January 1, 2010, in connection with the 2010 Regulatory Rate Decision, these assets became fully offset by a regulatory liability of \$11.2 million since the imputation of ICFA funds as CIAC effectively resulted in the Company not being able to benefit (through rates) from the acquired ICFA contracts.

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

As a result of Rate Decision No. 74364, the Company changed its policy around the ICFA related intangible assets. As discussed above, pursuant to Rate Decision No. 74364, approximately 70% of ICFA funds to be received in the future will be recorded as a HUF, until the HUF is fully funded at the Company's applicable utility subsidiary. The remaining approximate 30% of future ICFA funds will be recorded at the parent company level and will be subject to the Company's ICFA revenue recognition accounting policy. As the Company now expects to experience an economic benefit from the approximately 30% portion of future ICFA funds, 30% of the regulatory liability, or \$3.4 million, was reversed in 2014. The remaining 70% of the

regulatory liability, or \$7.9 million, will continue to be recorded on the balance sheet. At March 31, 2017 and December 31, 2016, this was the Company's sole regulatory liability.

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

3. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at March 31, 2017 and December 31, 2016 consist of the following (in thousands):

	March 31, 2017	December 31, 2016	Average Depreciation Life (in years)
Mains/lines/sewers	\$ 116,053	\$ 115,790	47
Plant	72,487	67,744	25
Equipment	29,847	29,100	10
Meters	4,645	4,637	12
Furniture, fixture and leasehold improvements	365	383	8
Computer and office equipment	680	1,056	5
Software	237	240	3
Land and land rights	764	764	
Other	226	226	
Construction work-in-process	56,124	53,426	
Total property, plant and equipment	281,428	273,366	
Less accumulated depreciation	(74,079)	(72,877)	
Net property, plant and equipment	<u>\$ 207,349</u>	<u>\$ 200,489</u>	

4. ACCOUNTS RECEIVABLE

Accounts receivable as of March 31, 2017 and December 31, 2016 consist of the following (in thousands):

	March 31, 2017	December 31, 2016
Billed receivables	\$ 1,402	\$ 1,547
Less allowance for doubtful accounts	(74)	(76)
Accounts receivable – net	<u>\$ 1,328</u>	<u>\$ 1,471</u>

5. EQUITY METHOD INVESTMENT

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

In March 2017, FATHOM™ completed a round of financing, wherein our ownership percentage was reduced from 8.0% to 7.1% on a fully diluted basis. In conjunction with the recapitalization, our equity interest was adjusted in accordance with ASC 323, *Investments-Equity Method and Joint Ventures*, wherein we recorded a gain of \$243,000 for the three months ended March 31, 2017. The adjustment to the carrying value of our investments was calculated using our proportionate share of FATHOM™'s adjusted net equity. The gain was recorded within other income and expense in our consolidated statement of operations. The carrying value of our investment consisted of a balance of \$602,000 as of March 31, 2017 and \$480,000 as of December 31, 2016, and reflects our initial investment, the adjustments related to subsequent rounds of financing, and our proportionate share of FATHOM™'s cumulative earnings (losses).

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

including the recent round of financing and the ability of FATHOM™ to achieve and sustain an earnings capacity that would justify the carrying amount of our investment, we do not believe the investment to be impaired as of March 31, 2017.

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

6. INTANGIBLE ASSETS

Intangible assets as of March 31, 2017 and December 31, 2016 consisted of the following (in thousands):

	March 31, 2017			December 31, 2016		
	Gross Amount	Accumulated Amortization	Net Amount	Gross Amount	Accumulated Amortization	Net Amount
INDEFINITE LIVED INTANGIBLE ASSETS:						
CP Water Certificate of Convenience & Necessity service area	\$ 1,532	\$ —	\$ 1,532	\$ 1,532	\$ —	\$ 1,532
Intangible trademark	13	—	13	13	—	13
	<u>1,545</u>	<u>—</u>	<u>1,545</u>	<u>1,545</u>	<u>—</u>	<u>1,545</u>
AMORTIZED INTANGIBLE ASSETS:						
Acquired ICFAs	17,978	(12,154)	5,824	17,978	(12,154)	5,824
Sonoran contract rights	7,406	(2,003)	5,403	7,406	(2,003)	5,403
	<u>25,384</u>	<u>(14,157)</u>	<u>11,227</u>	<u>25,384</u>	<u>(14,157)</u>	<u>11,227</u>
Total intangible assets						
	<u>\$ 26,929</u>	<u>\$ (14,157)</u>	<u>\$ 12,772</u>	<u>\$ 26,929</u>	<u>\$ (14,157)</u>	<u>\$ 12,772</u>

Acquired ICFAs and Sonoran contract rights are amortized when cash is received in proportion to the amount of total cash expected to be received under the underlying agreements. Due to the uncertainty of the timing of when cash will be received under ICFA agreements and contract rights, we cannot reliably estimate when the remaining intangible assets’ amortization will be recorded. No amortization was recorded for these balances for the three months ended March 31, 2017 and March 31, 2016.

7. TRANSACTIONS WITH RELATED PARTIES

On January 19, 2016, GWRC announced that it agreed to pursue a reorganization transaction with the Company that resulted in GWRC merging with and into the Company (the “Reorganization Transaction”). GWRC was organized in 2010 to acquire shares of the Company, and held an approximate 47.8% interest in the Company prior to the merger. The Reorganization Transaction closed on May 3, 2016. As a result of the Reorganization Transaction, GWRC ceased to exist as a British Columbia corporation and the Company, governed by the corporate laws of the State of Delaware, is the surviving entity.

GWRC was not part of the consolidated Company prior to the completion of the Reorganization Transaction. GWRC had no employees. GWRI provided for the ongoing management and general administration of GWRC’s business affairs pursuant to a management agreement between GWRC and GWRI to provide such services. Accordingly, GWRC was economically dependent on the Company. Services provided by the Company under the management agreement were provided at no charge to GWRC, and were not monetarily significant. However, GWRC incurred certain costs not covered by the management agreement. These included GWRC’s accounting fees, legal fees, listing fees, and other costs directly associated with its former status as a publicly traded company. Whereas GWRC did not expect to generate cash flows from operating activities, the operating costs incurred by GWRC and other cash requirements were paid by the Company. Amounts paid by the Company on GWRC’s behalf during the three months ended March 31, 2017 and 2016 totaled zero and \$497,000, respectively. The Company accounted for such payments as equity distributions to GWRC. In conjunction with the merger of GWRC into GWRI, the Company recorded \$731,000 in accounts payable and \$353,000 in deferred compensation on the books of GWRI that were previously recorded at GWRC. In addition to these liabilities, the Company also recorded an approximate \$1.4 million tax liability associated with the transfer of GWRC from Canada to the United States. A corresponding reduction in additional paid in capital was recorded with the merging of these liabilities into GWRI.

We provide 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 \$90,000 and \$280,000 for the three months ended March 31, 2017 and 2016, respectively.

GWM has historically provided billing, customer service, and other support services for the Company's regulated utilities. Amounts collected by GWM from the Company's customers that GWM has not yet remitted to the Company are included within the "Due from affiliates" caption on the Company's consolidated balance sheet. As of March 31, 2017 and December 31, 2016, the unremitted balance totaled \$444,000 and \$333,000, respectively. Notwithstanding the sale of GWM on June 5, 2013, GWM continues to provide these services to the Company's regulated utilities under a long-term service agreement. Based on current service connections, annual fees to be paid to GWM for FATHOM™ services will be approximately \$1.4 million at a rate of \$6.24 per water account/month. For the three months ended March 31, 2017 and 2016, the Company incurred FATHOM™ service fees of approximately \$360,000 and \$472,000, respectively.

Pursuant to the purchase agreement for the sale of GWM, the Company is entitled to quarterly royalty payments based on a percentage of certain of GWM's recurring revenues for a 10-year period, up to a maximum of \$15.0 million. In addition, the Company entered into a services agreement with GWM whereby the Company has agreed to use the FATHOM™ platform for all of its regulated utility services for an initial term of 10 years. The services agreement was amended on November 17, 2016, which extended the term of the contract through December 31, 2026. As part of the amended agreement, the Company reduced the monthly rate per connection from \$7.79 per water account/month to \$6.24 per water account/month. Additionally, the scope of services was expanded to include a meter replacement program of approximately \$10.9 million, wherein the Company intends to replace a majority of its meter infrastructure within the upcoming year. As of March 31, 2017, \$8.4 million has been utilized of the expected expenditure.

The services agreement is automatically renewable for successive 10-year periods, unless notice of termination is given prior to any renewal period. The services agreement may be terminated by either party for default only and the termination of the services agreement will also result in the termination of the royalty payments payable to the Company. The Company made the election to record these quarterly royalty payments prospectively in income as the amounts are earned. Royalties recorded within other income totaled approximately \$92,000 and \$88,000 for the three months ended March 31, 2017 and 2016, respectively.

8. ACCRUED EXPENSES

Accrued expenses at March 31, 2017 and December 31, 2016 consist of the following (in thousands):

	March 31, 2017	December 31, 2016
Deferred compensation	\$ 1,704	\$ 1,920
Meter replacement - related party	2,085	1,255
Property taxes	472	910
Interest	1,772	483
Dividend payable	458	458
Tax obligation related to GWRC merger	-	178
Other accrued liabilities	1,971	2,398
Total accrued liabilities	<u>\$ 8,462</u>	<u>\$ 7,602</u>

9. DEBT

The outstanding balances and maturity dates for short-term (including the current portion of long-term debt) and long-term debt as of March 31, 2017 and December 31, 2016 are as follows (in thousands):

	March 31, 2017		December 31, 2016	
	Short-term	Long-term	Short-term	Long-term
BONDS AND NOTES PAYABLE -				
4.380% Series A 2016, maturing June 2028	\$ —	\$ 28,750	\$ —	\$ 28,750
4.580% Series B 2016, maturing June 2036	—	86,250	—	86,250
	—	115,000	—	115,000
OTHER				
Capital lease obligations	7	6	25	54
Debt issuance costs	—	(726)	—	(737)
Total debt	<u>\$ 7</u>	<u>\$ 114,280</u>	<u>\$ 25</u>	<u>\$ 114,317</u>

2016 Senior Secured Notes – On June 24, 2016, the Company closed the Note Purchase Agreement entered into on May 20, 2016, and 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 existing long-term tax exempt bonds, which were subject to an early redemption option at 103%, plus accrued interest, as a result of the U.S. IPO. As part of the refinancing of the long-term debt, the Company paid a prepayment penalty of \$3.2 million and wrote off the remaining \$2.2 million in capitalized loan fees related to the tax exempt bonds, which were recorded as additional interest expense in the second quarter of 2016. The senior secured notes are collateralized by a security interest in the Company's equity interest in its subsidiaries, including all payments representing profits and qualifying distributions.

The senior secured notes require the Company maintain a debt service coverage ratio of consolidated EBITDA to consolidated debt service of at least 1.10 to 1.00. Consolidated EBITDA is calculated as net income plus depreciation, taxes, interest and other non-cash charges net of non-cash income. Consolidated debt service is calculated as interest expense, principal payments, and dividend or stock repurchases. The senior secured notes also contain a provision limiting the payment of dividends if the Company falls below a debt service ratio of 1.25. However, for the quarter ending June 30, 2021 through the quarter ending March 31, 2024, the ratio drops to 1.20. As of March 31, 2017, the Company was in compliance with its financial debt covenants.

At March 31, 2017, the remaining aggregate annual maturities of our debt and minimum lease payments under capital lease obligations for the years ended December 31 are as follows (in thousands):

	Debt	Capital Lease Obligations
2017	\$ —	\$ 5
2018	—	9
2019	—	1
2020	—	—
2021	1,917	—
Thereafter	113,083	—
Subtotal	115,000	15
Less: amount representing interest	—	(2)
Total	<u>\$ 115,000</u>	<u>\$ 13</u>

At March 31, 2017, the carrying value of the non-current portion of long-term debt was \$115.0 million, with an estimated fair value of \$110.8 million. At December 31, 2016, the carrying value of the non-current portion of long-term debt was \$115.0 million, with an estimated fair value of \$108.4 million. The fair value of our debt was estimated based on interest rates considered available for instruments of similar terms and remaining maturities.

10. INCOME TAXES

During the three months ended March 31, 2017, the Company recorded a tax expense of \$87,000 on a pre-tax income of \$137,000, compared to a tax benefit of \$222,000 on a pre-tax loss of \$536,000 for the three months ended March 31, 2016. 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.

11. DEFERRED COMPENSATION AWARDS

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

2011 stock option grant – At March 31, 2017 and December 31, 2016, there were options to acquire 43,395 shares of common stock of GWRI outstanding, adjusting for the 100.68 to 1.00 stock split effected on April 28, 2016. The options were all vested and exercisable as of each date. The stock options have a remaining contractual life of approximately 1.25 years and have a split-adjusted exercise price of \$8.65 per share.

2016 stock option grant – In May 2016, GWRI's Board of Directors granted stock options to acquire 325,000 shares of GWRI's common stock to the members of the board. The options were granted with an exercise price of \$7.50, the prevailing market price of the Company's common shares at the close of business on May 20, 2016. The options vest over a two-year period, with 50% vesting in May 2017 and 50% vesting in May 2018. The options have a three-year life. The Company will expense the \$2.1 million fair value of the stock option grant ratably over the two-year vesting period in accordance with ASC 323. Stock-based compensation expense of \$265,000 was recorded for the three months ended March 31, 2017. No stock-based compensation expense was recorded for the three months ended March 31, 2016.

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

PSUs are accounted for as liability compensatory awards under ASC 710, *Compensation – General*, rather than as equity awards. PSU awards are remeasured each period and a liability is recorded equal to GWRI's closing share price as of the balance sheet date multiplied by the number of units vested and outstanding. The value of the benefits is recorded as an expense in the Company's financial statements over the related vesting period. Vesting occurs ratably over 12 consecutive quarters beginning in the period granted. The following table details total awards granted and the number of units outstanding as of March 31, 2017 along with the amounts paid to holders of the PSUs for the three months ended March 31, 2017 and 2016 (in thousands, except unit amounts):

Grant Date	Units Granted	Units Outstanding	Amounts Paid For the Three Months March 31,	
			2017	2016
Q1 2013	76,492	—	—	29
Q1 2014	8,775	—	3	2
Q1 2015	28,828	9,609	22	13
Q1 2016	34,830	23,220	26	—
Q1 2017	22,712	22,712	—	—
Total	171,637	55,541	\$ 51	\$ 44

Stock appreciation rights compensation – Beginning January 2012, in an effort to reward employees for their performance, the Company adopted a stock appreciation rights plan authorizing the directors of the Company to issue stock appreciation rights ("SARs") to our employees. Following the consummation of the Reorganization Transaction, the value of the SARs

issued under the plan track the performance of GWRI's shares. Each holder has the right to receive a cash payment amounting to the difference between the exercise price and the closing price of GWRI's common shares on the exercise date, provided that the closing price is in excess of the exercise price. Holders of SARs may exercise their awards once vested. Individuals who voluntarily or involuntarily leave the Company forfeit their rights under the awards.

The Company historically accounted for SARs as liability compensatory awards under ASC 710, *Compensation – General*, valued using the intrinsic value method, as permitted by ASC 718 for nonpublic entities, with changes to the value of the SARs recognized as compensation expense at each quarterly reporting date. In connection with becoming a public company, as defined in ASC 718, in the first quarter of 2016, the Company was required to change its methodology for valuing the SARs. While the SARs will continue to be remeasured at each quarterly reporting date, the SARs are required to be accounted for prospectively at fair value using a fair value pricing model, such as Black-Scholes. The Company recorded the impact of the change in valuation methods as a cumulative effect of a change in accounting principle, as permitted by ASC 250. The effect of the change increased the SAR liability by \$103,000 which was the difference in compensation cost measured using the intrinsic value method and the fair value method. An offsetting change to accumulated deficit in the consolidated balance sheet was recorded with the revaluation, net of \$38,000 in taxes. Any future changes in fair value will be recorded as compensation expense in the consolidated statement of operations.

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

Recipients	Grant Date	Units Granted	Exercise Price	Units Outstanding	Amounts Paid For the Three Months Ended March 31,	
					2017	2016
Key Executive ⁽¹⁾⁽³⁾	Q3 2013	100,000	\$ 1.59	45,000	181	—
Key Executive ⁽¹⁾⁽⁴⁾	Q4 2013	100,000	\$ 2.69	50,500	154	—
Members of Management ⁽¹⁾⁽⁵⁾	Q1 2015	299,000	\$ 4.26	233,000	—	—
Key Executives ⁽²⁾⁽⁶⁾	Q2 2015	300,000	\$ 5.13	300,000	—	—
Total		799,000		628,500	\$ 335	\$ —

- (1) The SARs vest ratably over sixteen quarters from the grant date.
- (2) The SARs vest over sixteen quarters, vesting 20% per year for the first three years, with the remainder (40%) vesting in year four.
- (3) The exercise price was determined by taking the weighted average GWRC share price of the five days prior to the grant date of July 1, 2013.
- (4) The exercise price was determined by taking the weighted average GWRC share price of the 30 days prior to the grant date of November 14, 2013.
- (5) The exercise price was determined to be the fair market value of one share of GWRC stock on the grant date of February 11, 2015.
- (6) The exercise price was determined to be the fair market value of one share of GWRC stock on the grant date of May 8, 2015.

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

For the three months ended March 31, 2017 and 2016, the Company recorded approximately \$176,000 and \$188,000 of compensation expense related to the PSUs and SARs, respectively. Based on GWRI's closing share price on March 31, 2017, deferred compensation expense to be recognized over future periods is estimated for the years ending December 31 as follows (in thousands):

	PSUs	SARs
2017	\$ 188	\$ 610
2018	167	652
2019	66	93
2020	—	—
Total	\$ 421	\$ 1,355

12. SUPPLEMENTAL CASH FLOW INFORMATION

The following is supplemental cash flow information for the three months ended March 31, 2017 and 2016 (in thousands):

	For the Three Months Ended March 31,	
	2017	2016
Cash paid for interest	\$ 8	\$ 6
Cash paid for GWRC tax liability	125	—
Capital expenditures included in accounts payable and accrued liabilities	\$ 4,839	\$ 44
Equity method investment gain on recapitalization of FATHOM™	243	—
Deferred compensation change in accounting principle	\$ —	\$ 103

13. COMMITMENTS AND CONTINGENCIES

Commitments – Prior to the sale of GWM, we leased certain office space in Arizona under operating leases with terms that expired in February 2016. The operating lease agreements were between GWM and the landlord. Accordingly, effective June 2013 through February 2016, the Company was not a party under the lease agreements. GWRI subleased a portion of the office space covered under the GWM lease agreements. In February 2016, the Company entered into a three-year lease agreement with the landlord to occupy the same space previously subleased under GWM's lease agreements, inclusive of necessary facility upgrades. Beginning in March 2016, the Company began recording approximately \$8,000 in monthly rent expense related to the new agreement. Rent expense arising from the operating leases totaled approximately \$25,000 and \$18,000 for the three months ended March 31, 2017 and 2016, respectively.

Contingencies

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

14. SUBSEQUENT EVENTS

On May 10, 2017, the Company announced a monthly dividend increase from \$0.02250 per share (\$0.27000 per share annually) to \$0.02306 per share (\$0.27672 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 our compliance with applicable law, and depending on, among other things, our results of operations, 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.