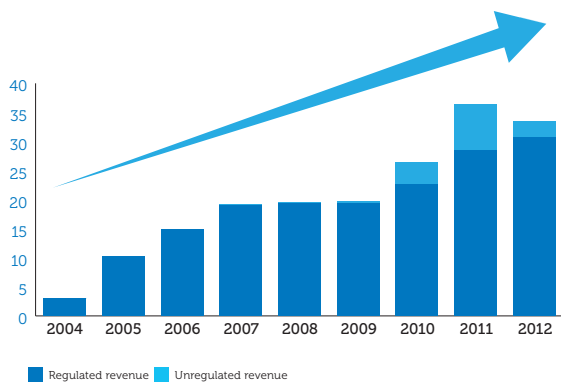




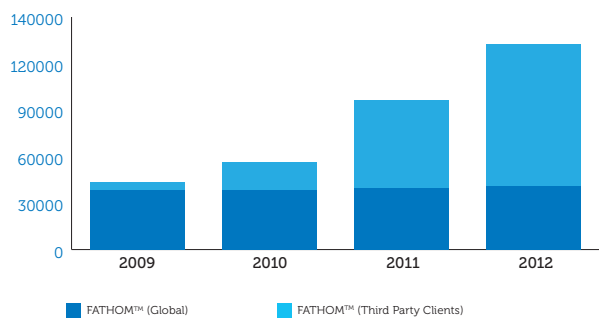
**GLOBAL WATER**

2012 Annual Report



Revenue Growth  
(Millions of USD)

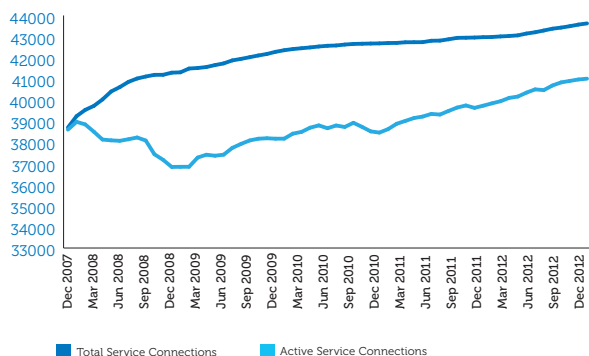
**34.9%**  
CAGR



FATHOM™ Account Growth

**132,500**

FATHOM™ Service Connections  
December 2012



Regulated Service Connections Growth

**41,008**

Active Service Connections  
December 2012

**3.21% annual organic growth in  
active connections**

# Dear Fellow Shareholders,

2012 was an exciting year for Global and 2013 promises to be a year of continued growth and expansion. Starting with our Regulated Utilities business, in 2012 we grew our regulated revenue by \$2.1 million, or 74%, to \$30.7 million compared with 2011. This increase in regulated revenue was due primarily to the rate increase phase-in effective January 1, 2012, pursuant to the 2010 Regulatory Rate Decision, as well as to organic growth in the number of service connections. We grew regulated active service connections to 41,008 at December 31, 2012, a 3.2% annual increase over 2011.

We have discussed previously how population and community growth in the metropolitan Phoenix area served by Global's utilities have a direct impact on our earnings; an increase or decrease in active service connections will affect our revenues and variable expenses in a corresponding manner. In this regard, Global has experienced eight consecutive quarters of organic service connection growth, and we believe the growth rate is now steadily improving.

According to 2010 U.S. Census Data, the Phoenix metropolitan statistical area ("MSA") had a population of 4.2 million in 2010 and is the 14th largest MSA in the U.S., an increase of 29% over the 3.25 million people in the 2000 census. Metropolitan Phoenix's growth data continues to improve, experiencing a 1.1% population increase in 2012, and a projected increase of 1.8% in 2013. This growth continues to be driven by low-cost housing, excellent weather, large and growing universities, a diverse employment base and low taxes. The University of Arizona Forecasting Project predicts that metropolitan Phoenix will have a population of 4.8 million by 2020. Recent projections from Elliott D. Pollack, a local and well known economist and housing market prognosticator, forecast an increase in employment in Greater Phoenix of 73,600 for 2013. Arizona added 50,500 jobs in 2012, ranking 3rd in job creation in the nation, up from 18th in December 2011. Greater Phoenix's employment had an increase of 51,800 jobs in 2012, a 3.0% gain year-over-year, according to Arizona State University ("ASU"). Additionally, the ASU W.P. Carey School of Business reported that Greater Phoenix was 2nd among large cities in the U.S. in job creation, up from 10th at this time last year.

Also, according to the W.P. Carey School of Business, Greater Phoenix Blue Chip Real Estate Consensus panel, virtually every sector of real estate is expected to improve through 2014. The consensus forecast is that single-family housing permits, after a decline to fewer than 6,800 units in 2011, bounced back to almost 12,500 units in 2012 and is expected to grow to 18,300 units in 2013 and over 25,500 units in 2014. Phoenix was one of the worst performing housing markets during the housing downturn, but prices have risen by 22.8% from November 2011 to November 2012 — the nation's largest annual increase, according to the recent S&P/Case-Shiller 20-city composite index. These gains are expected to help improve the local economy, and ultimately the housing market and occupancy rate in our service areas.

During the economic downturn beginning in 2008, GWRI's utilities experienced an increase in the number of vacant homes, reaching a peak of 4,647 vacant connections as of February 28, 2009; however, the negative trend began to reverse thereafter. Total vacant connections were 2,615, or 6.0% of GWRI's total service connections, as of December 31, 2012, compared with 3,241, or 7.5% of total service connections, as of December 31, 2011. This represents our lowest level of vacant connections since June 2008. Of the 1,277 active connections added in 2012, 651 were new connections and 626 were move-ins to previously foreclosed properties.

Global's growth strategy for the regulated business is driven by increased service connections, continued operating efficiencies as well as utility rate increases approved by the economic regulator, the Arizona Corporation Commission (ACC). In November 2012, the rate applications filed with the ACC for increased rates for the Company's utilities were determined sufficient by the ACC Staff. The evaluation process, including a formal rate hearing, is expected to conclude within one year and new rates will become effective.

The current revenue requirement in place was set in a rate case that concluded in 2010 and was based on a 2008 historic test year. Since that time, certain costs related to utility operations have increased and the Company is seeking to recover costs omitted from the last rate case to minimize the impact on rate payers. The Company continues to make the necessary capital improvements to maintain industry-leading performance for compliant operations, reliability, customer service and critical water resource management. The Company is also hopeful the ACC will reverse all, or a part, of its decision in the last rate case regarding the treatment of funds received from developers which would restore rate base for the Company. The rate applications request an adjustment to the revenue requirements for our utilities representing a collective rate increase of approximately 28%, or approximately \$8.4 million, of annualized revenues over 2012. We expect that the rate increase will be phased-in over a two to three year period.

Now regarding FATHOM™. During 2012, we grew recurring revenues of the FATHOM™ business by 26.6% to \$2.2 million, and the new arrangements entered into during 2012 will result in continued growth of recurring revenue in 2013. Even though our implementation revenue was lower than previous years, and although the FATHOM™ sales cycle remains challenging, the primary driver of FATHOM™'s value is recurring revenue. The FATHOM™ product continues to develop interest in the market place, and as we continue to invest in IT, the richness of the product continues to increase. Sales have been slower than hoped but steady and our pipeline of opportunities remains robust and growing.

The achievements of the past year are significant to our market position and enhance Global Water's growth potential going forward. FATHOM™ continues to build momentum within the United States and abroad. FATHOM™'s business expansion continues to include market adoption and expanding channels to market. The primary channels remain the direct sales and partner channels in both the national and the international markets. The opportunity that the FATHOM™ Operating System ("FATHOM™ OS") platform offers, coupled with the brand visibility associated with our international work, has driven an increased level of interest within both the national and international markets – particularly with larger municipalities with systems in need of updating or upgrading. This interest has also opened up an emerging channel to market for large cities based on the incremental capability of FATHOM™.



**Trevor T. Hill**

President and Chief Executive Officer

April 15, 2013

Please refer to the Company's Management's Discussion & Analysis and its Cautionary Statements regarding Forward-looking Statements which also applies to the Letter to Shareholders, as well as for a further detailed discussion of the Company and Global Water.

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March 28, 2013

To Our Shareholders:

GWR Global Water Resources Corp. (“**GWRC**”) is pleased to present our management’s discussion and analysis, along with management’s discussion and analysis of Global Water Resources, Inc. (“**GWRI**”), for the year ended December 31, 2012. Because GWRI represents the sole asset of GWRC and is not consolidated into the financial statements of GWRC, management’s discussion and analysis of GWRI for the year ended December 31, 2012 is filed together with management’s discussion and analysis of GWRC.

On behalf of the Board of Directors, President and Chief Executive Officer, management and employees of GWRC and GWRI, I thank you for your ongoing support.

Warm Regards,

Cindy M. Liles  
Executive Vice President and Chief Financial Officer

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS GWR GLOBAL WATER RESOURCES CORP.**

*The following management's discussion and analysis of GWR Global Water Resources Corp.'s (the "Company", "GWRC", "we", or "us") financial condition and results of operations dated March 28, 2013 relates to the years ended December 31, 2012 and 2011 and should be read together with our financial statements and related notes as of and for the years ended December 31, 2012 and 2011. Investors should also refer to the 2012 audited financial statements and the accompanying notes of GWRC as well as the consolidated financial statements and accompanying notes and the management's discussion and analysis of Global Water Resources, Inc. ("GWRI") and the Company's current annual information form, all of which are available on the Company's SEDAR profile at [www.sedar.com](http://www.sedar.com). Financial information of GWRI is not consolidated with the financial statements of GWRC.*

### ***Basis of Presentation***

The financial statements of the Company have been prepared in accordance with generally accepted accounting principles of the United States ("U.S. GAAP") and, except where otherwise indicated, are presented in U.S. dollars. Unless otherwise indicated, the financial information contained in this management's discussion and analysis has been prepared in accordance with U.S. GAAP and is expressed in U.S. dollars. References to "C\$" are to Canadian dollars.

In February 2008, the Accounting Standards Board (AcSB) of the Canadian Institute of Chartered Accountants (CICA) confirmed that publicly accountable enterprises would be required to convert to International Financial Reporting Standards (IFRS) in place of Canadian generally accepted accounting principles for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011.

In September 2010, the AcSB decided to offer an optional one year deferral for converting to IFRS for qualifying entities with rate regulated activities and permit such entities to continue to apply Part V – Pre-changeover accounting standards of the CICA Handbook during that period. The Company is a qualifying entity for purposes of this deferral which we elected.

Further, during 2011, we applied for, and in July 2011 received, an exemption from the Ontario Securities Commission allowing the Company and GWRI to adopt U.S. GAAP and defer their conversion to IFRS until financial years beginning on or after January 1, 2015. Accordingly, effective January 1, 2012, we converted to U.S. GAAP.

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

Certain statements in this management's discussion and analysis are forward-looking in nature and may constitute "forward-looking information" within the meaning of applicable securities laws. Often, but not always, forward-looking statements can be identified by the words "believes", "anticipates", "plans", "expects", "intends", "projects", "estimates", "objective" and similar expressions. These forward-looking statements reflect management's current expectations regarding GWRC's and GWRI's future growth, results of operations, performance and business prospects and opportunities and other future events and speak only as of the date of this management's discussion and analysis. Forward-looking statements should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not or the times at or by which such performance or results will be achieved. Investors are cautioned not to place undue reliance on forward-looking information. A number of factors could cause actual results to differ materially from the results discussed in the



forward-looking statements, including, but not limited to, the factors discussed under “Risk Factors” in GWRC’s most recent Annual Information Form, which is available on SEDAR at [www.sedar.com](http://www.sedar.com). Although the forward-looking statements contained in this management’s discussion and analysis are based upon what management believes to be reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward-looking statements, and the differences may be material. These forward-looking statements are made as of the date of this management’s discussion and analysis and neither GWRC nor GWRI assume any obligation to update or revise them to reflect new events or circumstances, except as required by applicable law.

## Executive Overview

**General** – The Company was incorporated under the *Business Corporations Act* (British Columbia) on March 23, 2010 to acquire shares of GWRI, a corporation incorporated in the State of Delaware of the United States of America, and to actively participate in the management, business and operations of GWRI through its representation on the board of GWRI and its shared management with GWRI. The formation of GWRI occurred on December 30, 2010 through a reorganization of Global Water Resources, LLC and its subsidiaries and Global Water Management, LLC (the predecessors of GWRI).

GWRI operates in the Western United States as a water resource management company that owns and operates regulated water, wastewater and recycled water utilities in strategically located communities, principally in metropolitan Phoenix, Arizona. GWRI’s model focuses on the broad issues of water supply and scarcity and applies principles of water conservation through water reclamation and reuse. The basic premise of GWRI’s business is that the world’s water supply is limited and yet can be stretched significantly through effective planning, the use of recycled water and by providing individuals and communities resources that promote wise water usage practices. GWRI deploys its integrated approach, Total Water Management (“TWM”), a term which it uses to mean managing the entire water cycle, both to conserve water and to maximize its total economic and social value. GWRI uses TWM to promote sustainable communities in areas where GWRI expects growth to outpace the existing potable water supply.

Through its investment in technology, GWRI’s utilities are some of the most automated and efficient operations in the U.S. water industry. Initially developed to support and optimize its own utilities, GWRI also has an unregulated business, whose services are now marketed by GWRI as FATHOM Utility-to-Utility (“U<sub>2</sub>U™”) Solutions (“FATHOM™”). FATHOM™ offers an integrated suite of advanced technology-enabled platforms to provide attractive third party services to municipalities and private utilities. The services offered by FATHOM™ have been proven to provide immediate cost savings and opportunities for increased revenues.

On December 30, 2010, the Company completed its initial public offering of 8,185,000 common shares (the “Offering”) at C\$7.50 per share for gross proceeds totaling C\$61,387,500. The Company used the net proceeds of the Offering to acquire 81,850 shares of GWRI common stock, as contemplated in the Prospectus. On January 28, 2011, the underwriters of the Offering exercised their over-allotment option and purchased an additional 569,611 common shares at C\$7.50 per share. Net proceeds from the exercise of the over-allotment option, after taking into account underwriters’ commissions and issuance costs of \$262,000, were \$4,011,000. The net proceeds of the over-allotment were used to purchase 5,696 shares of GWRI’s common stock on January 28, 2011, increasing the Company’s ownership interest in GWRI to approximately 48.1%.



**Results of operations for the years ended December 31, 2012 and 2011** –The following table summarizes GWRC’s results of operations for the years ended December 30, 2012 and 2011 (in thousands of US\$, except per share amounts).

	<b>For the Years Ended December 31,</b>	
	<b>2012</b>	<b>2011</b>
Loss from equity investment.....	\$ (18,694)	\$ (1,580)
Operating expenses.....	397	255
Operating loss .....	(19,091)	(1,835)
Loss before income taxes.....	(19,091)	(1,835)
Income tax benefit.....	-	-
Net loss.....	\$ (19,091)	\$ (1,835)
Loss per share .....	\$ (2.18)	\$ (0.21)
Loss per share, excluding effect of GWRI valuation allowance.....	\$ (0.33)	\$ (0.21)

To date, the Company has not declared any dividends.

**Loss from Equity Investment** – Loss from equity investment for the years ended December 31, 2012 and 2011 represents the portion of GWRI’s net loss attributed to the equity method investment during the period. The amount is calculated based on GWRI’s net loss for the years ended December 31, 2012 and 2011, multiplied by GWRC’s equity method interest in GWRI during the period, also taking into consideration the fact that GWRC’s equity method interest in GWRI increased on January 28, 2011 from approximately 46.4% to approximately 48.1%. In addition, loss from equity investment includes amortization of the difference between the cost of the investment and the underlying net assets of the investee at the date of investment, attributed to the intangible asset (see note 3 of the Company’s financial statements for the year ended December 31, 2012). For a discussion of GWRI’s results of operations, please see GWRI’s management’s discussion and analysis, which is available on the Company’s SEDAR profile at [www.sedar.com](http://www.sedar.com).

**Operating Expenses** – Operating expenses for the years ended December 31, 2012 and 2011 consisted primarily of stock-based compensation, compensation provided to the independent members of the Company’s board of directors, accounting fees, directors’ and officers’ insurance, listing fees and other costs directly associated with operating as a publicly traded company.

**Net Loss** – Net loss of \$19,091,000 and \$1,835,000 for the years ended December 31, 2012 and 2011, respectively, was determined by deducting operating expenses from loss from equity investment. The increased loss on equity investment for the years ended December 31, 2012 was primarily a result of a valuation allowance recorded against GWRI’s net deferred tax assets during the second quarter of 2012. Excluding the impact of the valuation allowance recorded by GWRI, the loss totaled \$2,900,000 for the year ended December 31, 2012, or \$(0.33) per share for the year ended December 31, 2012.

The following table sets forth unaudited financial data for the last eight quarters ended December 31, 2012 (in thousands of US\$). This financial information has been derived from the unaudited financial statements prepared by, and is the responsibility of, the Company's management.

	2012				2011			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
LOSS FROM EQUITY INVESTMENT.....	\$ (874)	\$ (321)	\$ (16,448)	\$ (1,051)	\$ (676)	\$ (49)	\$ (367)	\$ (488)
OPERATING EXPENSES.....	64	53	156	124	35	37	71	112
OPERATING LOSS .....	(938)	(374)	(16,604)	(1,175)	(711)	(86)	(438)	(600)
LOSS BEFORE INCOME TAXES.....	(938)	(374)	(16,604)	(1,175)	(711)	(86)	(438)	(600)
INCOME TAX BENEFIT .....	-	-	-	-	-	-	-	-
NET LOSS .....	\$ (938)	\$ (374)	\$ (16,604)	\$ (1,175)	\$ (711)	\$ (86)	\$ (438)	\$ (600)
LOSS PER SHARE .....	\$ (0.11)	\$ (0.04)	\$ (1.90)	\$ (0.13)	\$ (0.08)	\$ (0.01)	\$ (0.05)	\$ (0.07)
LOSS PER SHARE, EXCLUDING EFFECT OF GWRI VALUATION ALLOWANCE .....	\$ (0.07)	\$ (0.03)	\$ (0.10)	\$ (0.13)	\$ (0.08)	\$ (0.01)	\$ (0.05)	\$ (0.07)

## **Outstanding Share Data**

As of March 28, 2013, there were 8,754,612 common shares of the Company outstanding and options to acquire an additional 385,697 common shares of GWRC.

## **Liquidity and Capital Resources**

We are economically dependent on GWRI. Our ability to service operating costs and pay distributions (if any) is entirely dependent on the receipt of distributions, or loans, from GWRI. Significant events affecting or transactions involving GWRI could materially influence our ability to make such payments.

We do not carry on any active business operations as our activities are generally restricted to holding securities of our equity investee, GWRI. To date, we have not incurred debt to finance our investments. Therefore, our capital structure is composed solely of our shareholders' equity.

To date, capital resources have been provided from equity financing, and there were no cash flows of the Company for the years ended December 31, 2012. GWRI has funded the Company's operating expenses incurred through December 31, 2012. See Notes 3 and 6 to GWRC's financial statements for the year ended December 31, 2012.

## **Insurance Coverage**

As we do not carry on any active business operation, the Company does not carry insurance coverage other than a \$10,000,000 Directors' and Officers' Liability insurance policy. GWRI carries financial insurance policies with limits, deductibles and exclusions consistent with industry standards. However, insurance coverage may not be adequate or available to cover unanticipated losses or claims.

## **Contractual Obligations and Commitments**

GWRC had no significant contractual obligations or commitments with third parties as of December 31, 2012.

## **Quantitative and Qualitative Disclosure about Market Risk**

Through its equity interest in GWRI, the Company is indirectly exposed to market risk associated with changes in interest rates and with price increases for chemicals, electricity and labor that affect the business of GWRI. However, the potential for an increase is mitigated by GWRI's ability to recover its costs through rate increases to its customers as well as the fact that it holds fixed-rate debt.

The Company's future performance and financial condition involves a number of risks and uncertainties. Any of these risks and uncertainties could have a material adverse effect on the results of operations, business prospects and financial condition of GWRI, the Company or the market price or value of the Company's common shares. These risks are discussed in the Company's most recent Annual Information Form, which is available on SEDAR at [www.sedar.com](http://www.sedar.com)

## **Related Party Transactions**

Except for the Chief Executive Officer and Chief Financial Officer (who serve the same roles at GWRI and receive no compensation from the Company in connection with their roles), we have no employees and the management and general administration services for our business and affairs are provided by GWRI pursuant to a management agreement. Services provided by GWRI are provided at no charge to the Company.

The management agreement may be terminated (i) by the Company, in its sole discretion, by notice in writing to GWRI at least 30 days prior to the effective date of termination; (ii) by either party in the event of the termination of the existence of the Company or the insolvency, receivership or bankruptcy of GWRI, or in the case of default by the other party in the performance of a material obligation under the management agreement which is not remedied within 30 days after notice thereof has been delivered to the defaulting party; and (iii) if the Company no longer holds voting securities of GWRI.

For a description of the specific services provided by GWRI to the Company under the management agreement, please refer to the management agreement, a copy of which has been filed on SEDAR at [www.sedar.com](http://www.sedar.com).

*Stock option grant to employees of GWRI* – In January 2012, the Company’s Board of Directors granted options to acquire 385,697 GWRC common shares to nine employees of GWRI pursuant to the GWR Global Water Resources Corp. Stock Option Plan (the “Option Plan”). The options vest in equal installments over the eight quarters of 2012 and 2013 and expire four years after the date of issuance. We account for the option grant in accordance with FASB’s Accounting Standards Codification (ASC) 323, *Investment-Equity Method & Joint Ventures*. At December 31, 2012, the estimated fair value of the options was \$33,000 based on a Black-Scholes pricing model. The Company will remeasure the fair value of the award at the end of each period until the options are fully vested.

As part of loss from equity investment, 48.1% of the stock compensation cost recorded by GWRI as a result of the award under the Option Plan is included in the Company’s statement of operations, reflecting the Company’s equity method interest in GWRI’s results of operations. Additionally, whereas the Company is providing the entire compensation award to GWRI despite the Company’s 48.1% interest, the Company recorded compensation expense within operating expenses related to the stock option award totaling \$51,000 for the year ended December 31, 2012, representing the remaining 51.9% of the total compensation for such awards. This 51.9% amount represents the amount that the Company’s claim on GWRI’s book value has not been increased which benefits the noncontributing investors.

### **Critical Accounting Policies and Estimates**

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

A summary of GWRC’s significant accounting policies used in the preparation of its financial statements appears in Note 2 of GWRC’s financial statements for the years ended December 31, 2012. GWRC has identified policies related to the application of the equity method to its investment in GWRI and its assessment of impairment of such investment as critical to its business operations and the understanding of its results of operations. Management has reviewed those critical accounting policies and the associated estimates and assumptions.

Additionally, as indicated above, effective January 1, 2012, the Company and GWRI prepare their financial statements in accordance with U.S. GAAP. See also Note 1 to GWRC’s financial statements for the year ended December 31, 2012.

## **Disclosure Controls and Procedures and Internal Control over Financial Reporting**

### *Evaluation of Disclosure Controls and Procedures*

Our Chief Executive Officer and Chief Financial Officer reviewed and evaluated our disclosure controls and procedures. Based on that evaluation, they have concluded that our disclosure controls and procedures are effective in providing them with timely material information relating to the Company.

### *Management's Annual Report on Internal Control Over Financial Reporting*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, and has designed such internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of financial statements for external purposes in accordance with U.S and Canadian GAAP.

Management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our internal controls and procedures over financial reporting will prevent all error and all fraud. A control system can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving our stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has evaluated the design and operation of our internal control over financial reporting as of December 31, 2012, and has concluded that such internal control over financial reporting is effective as of December 31, 2012. There are no material weaknesses that have been identified by management in this regard. This assessment was based on criteria for effective internal control over financial reporting described in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

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

There were no changes in our internal control over financial reporting during the last fiscal year that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **Other Required Disclosures**

Additional information relating to GWRC, including the Company's Annual Information Form, has been filed on SEDAR at [www.sedar.com](http://www.sedar.com).

\* \* \* \* \*

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS GLOBAL WATER RESOURCES, INC.**

*The following management's discussion and analysis of Global Water Resources, Inc.'s (the "Company", "GWRI", "we", or "us") financial condition and results of operations dated March 28, 2013 relates to the years ended December 31, 2012 and 2011 and should be read together with the consolidated financial statements and the accompanying notes of GWRI as well as GWR Global Water Resources Corp.'s ("GWRC") financial statements and related management's discussion and analysis and current annual information form, all of which are available on GWRC's SEDAR profile at [www.sedar.com](http://www.sedar.com). Financial information of GWRC is not consolidated with financial information of GWRI.*

### ***Basis of Presentation***

The financial statements of Global Water Resources, Inc. have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") and, except where otherwise indicated, are presented in U.S. dollars. Unless otherwise indicated, the financial information contained in this management's discussion and analysis has been prepared in accordance with U.S. GAAP and is expressed in U.S. dollars and references to "\$", "US\$" and "dollars" are to U.S. dollars. References to "C\$" are to Canadian dollars.

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

Certain statements in this management's discussion and analysis are forward-looking in nature and may constitute "forward-looking information" within the meaning of applicable securities laws. Often, but not always, forward-looking statements can be identified by the words "believes", "anticipates", "plans", "expects", "intends", "projects", "estimates", "objective", "goal", "focus", "aim" and similar expressions. These forward-looking statements reflect management's current expectations regarding the GWRC's and GWRI's future growth, results of operations, performance and business prospects and opportunities and other future events and speak only as of the date of this management's discussion and analysis. Forward-looking statements should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not or the times at or by which such performance or results will be achieved. Investors are cautioned not to place undue reliance on forward-looking information. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed under "Risk Factors" in GWRC's most recent Annual Information Form, which is available on GWRC's SEDAR profile at [www.sedar.com](http://www.sedar.com). Although the forward-looking statements contained in this management's discussion and analysis are based upon what management believes to be reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward-looking statements, and the differences may be material. These forward-looking statements are made as of the date of this management's discussion and analysis and neither GWRI nor GWRC assumes any obligation to update or revise them to reflect new events or circumstances, except as required by applicable law.

### ***Cautionary Statement Regarding Non-GAAP Measures***

This management's discussion and analysis contains references to "EBITDA". EBITDA is defined for the purposes of this management's discussion and analysis as net income or loss before interest, income taxes, depreciation and amortization. Management believes that EBITDA is a useful supplemental measure of GWRI's operating performance and that the use of EBITDA facilitates operating performance comparisons from period to period and company to company by removing potential differences caused by variations in capital structures (affecting primarily relative interest expense), the book amortization of intangibles (affecting relative amortization expense),

the age and book depreciation of facilities and equipment (affecting relative depreciation expense), other non-cash charges and non-recurring items. Management believes that, by eliminating such effects, EBITDA provides a meaningful measure of overall corporate performance exclusive of GWRI's capital structure and the method and timing of expenditures associated with building and placing GWRI's systems. EBITDA is also presented because management believes that it is frequently used by securities analysts, investors and other interested parties as a measure of financial performance.

However, EBITDA is not a recognized earnings measure under U.S. GAAP and does not have a standardized meaning prescribed by U.S. GAAP. Therefore, EBITDA may not be comparable to similar measures presented by other issuers. Investors are cautioned that EBITDA should not be construed as an alternative to net income or loss or other income statement data (which are determined in accordance with U.S. GAAP) as an indicator of the performance of GWRI or as a measure of liquidity and cash flows. Management's method of calculating EBITDA may differ materially from the method used by other public companies and accordingly, may not be comparable to similarly titled measures used by other public companies. See "EBITDA" for a reconciliation of EBITDA to net loss, the nearest comparable U.S. GAAP measure.

## Overview

**General** – GWRI is a leading water resource management company, co-founded in Phoenix in 2003 by President and Chief Executive Officer Trevor T. Hill and investor William S. Levine. GWRI recognized that population growth and shrinking water supplies had the potential to overwhelm small, undercapitalized and under-engineered water utilities and that the Company's unique water management approach could have the potential to achieve local conservation objectives and maximize the economic value of water.

The basic premise of GWRI's business is that the world's water supply is limited and yet can be stretched significantly through effective planning, the use of recycled water and by providing individuals and communities resources that promote wise water usage practices. GWRI deploys its integrated approach, Total Water Management ("TWM"), a term which it uses to mean managing the entire water cycle, both to conserve water and to maximize its total economic and social value. GWRI uses TWM to promote sustainable communities in areas where GWRI expects growth to outpace the existing potable water supply. GWRI's business comprises two principal divisions: our Regulated business consisting of the Company's regulated utilities, and our Unregulated business consisting primarily of our FATHOM Utility-to-Utility ("U<sub>2</sub>U<sup>TM</sup>") Solutions ("FATHOM<sup>TM</sup>") operations. Through its Regulated division, GWRI operates in the Western United States as a water resource management company that owns and operates regulated water, wastewater and recycled water utilities in strategically located communities, principally in metropolitan Phoenix, Arizona. GWRI's model focuses on the broad issues of water supply and scarcity and applies principles of water conservation through water reclamation and reuse.

Leveraging its investment in technology that was initially developed to support and optimize its own utilities, GWRI also has an Unregulated business, whose services are now marketed by GWRI as FATHOM<sup>TM</sup>. FATHOM<sup>TM</sup> offers an integrated suite of cloud-based geo-spatial advanced technology-enabled platforms to provide attractive third party services to municipalities and private utilities of any size. The services offered by FATHOM<sup>TM</sup> provide automation, cost savings and opportunities for increased revenues to our municipal and private utility clients.

The Company had 143 employees at December 31, 2012.

Our Regulated division provides drinking water, wastewater and other water related services to approximately 65,000 people in Arizona. In addition to the Regulated division, we provide unregulated FATHOM<sup>TM</sup> services to approximately 321,000 people in Arizona and California of which 256,000 are customers of third party clients. Our Regulated business involves the ownership of water and wastewater utilities that provide water and wastewater



services to residential, commercial and industrial customers. Our utilities that provide these services are subject to economic regulation by the state regulator, the Arizona Corporation Commission (“ACC”). The U.S. federal and state governments also regulate environmental, health and safety and water quality matters. GWRI’s financial condition and results of operations for the Regulated division are influenced by a variety of industry-wide factors, including but not limited to (i) economic utility regulation; (ii) economic environment; (iii) the need for infrastructure investment; (iv) an overall trend of declining water usage per customer; (v) weather and seasonality; and (vi) access to and quality of water supply.

GWRI’s financial condition and results of operations for FATHOM™, of which operations are not directly subject to economic regulation by any governmental regulatory agencies, are primarily influenced by the effectiveness of project implementations and the success of our recurring services, including customer satisfaction.

During 2012, we continued to execute on our strategy of providing value to our customers and shareholders by aiming to deliver solid financial results, making capital investments in our infrastructure and focusing on efforts to earn an appropriate rate of return on prudent investments. Most notably, effective January 1, 2012, pursuant to the 2010 Regulatory Rate Decision of the ACC (as defined below) our Regulated division experienced the last of the three part phase-in of higher rates for certain customers.

## **UNREGULATED DIVISION**

### ***Market Adoption and Implementation of FATHOM™ Services***

Since early 2011, we have provided utility customer and billing services for the City of Torrance to approximately 28,000 water/sewer/rubbish accounts, and an additional approximate 8,000 rubbish only accounts. In September 2012, we entered into an additional agreement with the City of Torrance to extend the use of FATHOM™ across additional service connections of the City. In October 2012, GWRI began providing customer and billing services for sewer services to the 8,000 existing rubbish only accounts, and an additional customer and billing services for 2,000 new sewer customers.

In March 2012, we entered into an agreement with the City of El Cajon, California to provide the Customer Information System (“CIS”) FATHOM™ utility billing services and web presentment to approximately 16,000 accounts. The implementation has been substantially completed, and services commenced in October 2012.

Also in March 2012, the City Council of the City of South Pasadena, California, approved the selection of FATHOM™ solutions for their water, wastewater and refuse operations, representing approximately 6,200 service connections. The contract with the city was finalized in August 2012. Recurring services to South Pasadena commenced in January 2013.

In May 2012, the Goleta Water District in California approved the adoption of the FATHOM™ Utility-to-Utility Solutions for CIS, inclusive of electronic billing and payment for a multi-year billing services contract, representing approximately 16,600 service connections. Recurring services to Goleta commenced in December 2012.

In November 2012, the City of Adelanto, California, approved the selection of FATHOM™ platform to provide the city with a fully integrated, end-to-end CIS, including utility billing and customer care, the Automated Meter Infrastructure (“AMI”) System and Asset Management System. The contract is currently being negotiated and represents approximately 7,400 service connections in the City of Adelanto.

In December 2012, the City of Kennedale, Texas contracted with GWRI to provide the City with fully integrated, end-to-end FATHOM™ CIS, including utility billing, customer care and AMI for 2,600 connections. This is GWRI's first recurring services contract in the State of Texas and the City's selection of FATHOM™ is significant as it represents direct action by the city to address the area's ongoing drought with effective water conservation plans, powerful customer services tools, upgraded infrastructure, and real-time data.

We continue to advance our relationship with Thames Water Utilities Ltd in the United Kingdom ("Thames Water"). In May 2012, we entered into an agreement with Thames Water to develop and implement a data hosting, analytics, billing and consumer presentment interface for Thames Water's high-value commercial consumers. During the three months between June 2012 and September 2012, we provided water consumption presentment resources to Thames Water for between 500 and 2,500 high-value commercial meters.

In December 2012, we entered into a new Thames Water agreement to develop a FATHOM™ prototype for Thames Water such that they can determine if they can leverage the power of the platform. During 2013, we will construct a model customer service office designed to deliver better customer service to over 60,000 of Thames Water's residential customers and all commercial customers that consume more than five megaliters of water per year. Under this agreement, we will customize FATHOM™'s cloud-based CIS for Thames Water's specific requirements. This project leverages the initial automated metering infrastructure pilot work completed by Thames Water and GWRI earlier in 2012, and will explore the benefits of real-time data to customers, providing them actionable information on their water use through FATHOM™'s customer portal.

In addition, in February 2013, we received a separate purchase order from Thames Water to develop billing and web presentment resources for out-of-area commercial customers. This project will be performed in tandem with the larger Thames Water contract and leverages the work performed for Thames Water in 2012.

The business expansion of FATHOM™ continues to include market adoption and expanding channels to market. The primary channels remain the direct sales and partner channels in both the national and the international markets. With the opportunity offered by our FATHOM™ Operating System ("FATHOM™ OS") platform, coupled with the brand visibility associated with the Thames Water project, there has been an increase of interest within both the national and international markets – particularly with larger municipalities with systems in need of updating or upgrading. This interest has also opened up an emerging channel to market for large cities based on the incremental capability of FATHOM™. We have capitalized on the incremental channel through follow on work with one of these customers.

The direct sales team has continued to focus on the small to midsized market in six regions – Arizona, California, Colorado, Florida, Texas and the Pacific Northwest. We believe the municipalities in these regions continue to experience the worsening municipal financial situations, water scarcity and increased regulation that FATHOM™ was designed to address. As these factors continue to persist, we believe our position will continue to strengthen. As we begin 2013, we began implementing our first Texas client a full service CIS and AMI project.

The partner channel continues to develop with a renewed focus to capitalize on the momentum from the FATHOM™ OS platform. The most prominent of which is our operating partnership with the Ontario Clean Water Agency ("OCWA"). OCWA operates 140 municipal water entities representing approximately 1,000,000 meters and has renewed their commitment to the FATHOM™ platform with a formal agreement to begin marketing and selling FATHOM. In addition, Global Water continues to pursue several other operating partnerships as well as technological partnerships that we expect will further bolster adoption of FATHOM™.

In 2011, we launched our U<sub>2</sub>You™ customer portal website and the first ever iPhone application for water utilities, and in July 2012, we launched the FATHOM™ Mobile Android applications. In May 2012, we officially launched FATHOM™ OS and unveiled it at the CS Week conference in Dallas, where we had a large presence. The development of FATHOM™ OS underscores the significant intellectual property imbedded in the platform and not only makes our platform more powerful and agile, but also makes us much less reliant on third party vendors. As a utility company ourselves with almost 150,000 meters on our platform, we are larger than most of our potential clients in the market; which we believe makes our services extremely compelling and is our strongest sustainable competitive advantage, as it allows us to speak from experience on how a back-office should operate.

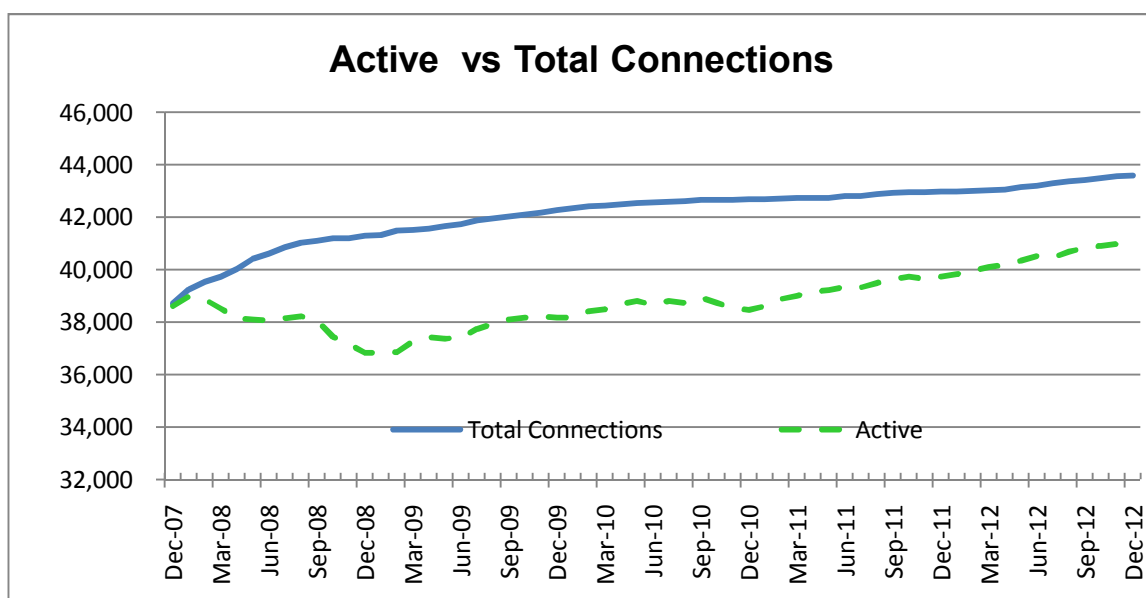
In many ways, these customer facing tools are revolutionary for the water utility sector; not only improving the customer's ability to manage and pay their bills but also giving them useful information about their own water consumption. With U<sub>2</sub>You™, customers can see their daily water consumption data in near real-time, in addition to their consumption data benchmarked against their neighbors, their street and their community. In many areas, where conservation is critical, it is this type of information that has been proven to be very impactful on community water consumption. The Company's focus on customer facing tools is not typical in the water sector. The FATHOM™ platform not only provides municipalities with the opportunity for increased revenue and decreased costs, it opens a unique customer interface opportunity which in time will have the potential to increase the Company's revenue from our municipal clients and end-user customers alike. Our continuous investment in the FATHOM™ platform provides for more automation in business processes, provides more analytical capabilities, improves customer service metrics and lowers costs of operations.

## REGULATED DIVISION

### *Population and Community Growth*

Population and community growth in the metropolitan Phoenix area served by GWRI's utilities have a direct impact on its earnings. An increase or decrease in GWRI's active service connections will affect its revenues and variable expenses in a corresponding manner.

As illustrated in the graph below, GWRI's total service connections, which include active service connections and connections to vacant homes, increased to 43,623 as of December 31, 2012 from 42,972 as of December 31, 2011. GWRI's active service connections increased to 41,008 as of December 31, 2012 compared to 39,731 as of December 31, 2011, representing an annual increase of 3.2%. Management is encouraged by the growth in active service connections in 2012.



During the economic downturn beginning in 2008, GWRI's utilities experienced an increase in the number of vacant homes, reaching a peak of 4,647 vacant connections as of February 28, 2009; however, the negative trend began to reverse thereafter. Total vacant connections were 2,615, or 6.0% of GWRI's total service connections, as of December 31, 2012, compared with 3,241, or 7.5% of total service connections, as of December 31, 2011. This represents our lowest level of vacant connections since June 2008. Of the 1,277 active connections added this year, 651 were new connections and 626 were move-ins to previously foreclosed properties.

According to the 2010 U.S. Census Data, the Phoenix metropolitan statistical area ("MSA") had a population of 4.2 million in 2010 and is the 14th largest MSA in the U.S., an increase of 29% over the 3.25 million people in the 2000 census. Metropolitan Phoenix's growth data continues to improve, experiencing a 1.1% population increase in 2012, and a projected increase of 1.8% in 2013. This growth continues to be driven by low-cost housing, excellent weather, large and growing universities, a diverse employment base and low taxes. The University of Arizona Forecasting Project predicts that metropolitan Phoenix will have a population of 4.8 million by 2020. Recent projections from Elliott D. Pollack & Company forecast an increase in employment in Greater Phoenix of 73,600 for 2013. Arizona added 50,500 jobs in 2012, ranking 3rd in the nation, up from 18th in December 2011. Greater Phoenix's employment had an increase of 51,800 jobs in 2012, a 3.0% gain year-over-year, according to Arizona

State University (“ASU”) and the Department of Commerce, Research Administration, while forecasting annual percentage change in job growth in the Greater Phoenix area will be another 2.5% in 2013. Additionally, the ASU W.P. Carey School of Business reported that Greater Phoenix was 2nd among large cities in the U.S. in job creation, up from 10th at this time last year.

Also, according to the W.P. Carey School of Business, Greater Phoenix Blue Chip Real Estate Consensus panel, virtually every sector of real estate is expected to improve through 2014. The consensus forecast is that single-family housing permits, after a decline to fewer than 6,800 units in 2011, bounced back to almost 12,500 units in 2012 and is expected to grow to 18,300 units in 2013 and over 25,500 units in 2014. Phoenix was one of the worst performing housing markets during the housing downturn, but prices have risen by 22.8% from November 2011 to November 2012 — the nation's largest annual increase, according to the recent S&P/Case-Shiller 20-city composite index. These gains are expected to help improve the local economy.

GWRI’s acquired utilities and monopolistic service territories are directly in the anticipated path of growth primarily in the metropolitan Phoenix area. We estimate that the Company’s service areas currently incorporate a large portion of the final platted lots, partially finished lots and finished lots in metropolitan Phoenix. Management believes that GWRI is well-positioned to benefit from the near-term growth in metropolitan Phoenix due to the availability of lots and existing infrastructure in place within GWRI’s services areas. This is further supported by the following key factors (all information from the CRA February 2013 report):

- There is virtually no foreclosure “shadow” (inventory) left, with less than 1,500 units remaining in the market.
- There is the lowest resale inventory in 15 years, at less than 3 months supply in several key competitive areas.
- There are only 181 active subdivisions in the Phoenix Metro market, down substantially from the historical norm which typically exceeds 500 active subdivisions.
- These factors have resulted in the highest price for finished lot transactions since 2006 in several competitive sub-markets, exceeding \$60,000 per lot in 2012.

In October 2012, GWRI, Global Water – 303 Utilities Company, Inc. (“303 Utilities Company”), and the City of Glendale entered into an agreement for future wastewater and recycled water services, advancing our public-private-partnership originally established in a Memorandum of Understanding approved by City Council in March 2010. We believe that this is a significant achievement and speaks to the recognized value of our Total Water Management utility model, as we have been working with Glendale and the landowners in the area for over four years to get a multi-party solution in-place.

The agreement names GWRI’s subsidiary 303 Utilities Company as the wastewater and recycled water provider that the City wishes to work to establish service for a 7,000-acre territory within a portion of the City’s western planning area. Due to its proximity to major transportation corridors and Luke Air Force Base, we expect the territory will be integral to the City’s future industrial and commercial growth strategies.

The 303 Utilities Company has also signed agreements with landowners in the service area to fund the initial design and construction of a wastewater and recycled water utility. The landowners desire for the land to be “Shovel Ready” within 18 to 24 months, anticipating infrastructure to be constructed immediately thereafter.

On January 30, 2013, the 303 Utilities Company filed with the Arizona Corporation Commission (“ACC”) its Notice of Intent to file an application for a certificate of convenience and necessity for approximately 3,500 acres to allow for the development of an initial phase of wastewater service.

In addition, we have signed separate agreements with the same landowners to provide the coordination, permitting, and engineering work for the related water utility service element of the project. This is the first true engineering services offering our company will provide for use by external clients.

### ***Economic Utility Regulation***

The ACC is charged with establishing rates based on the provision of reliable service at reasonable cost while also providing an opportunity to earn a fair rate of return on rate base for investors of utilities. The ACC uses an historical test year to evaluate whether the plant in service is used and useful, to assess whether costs were prudently incurred and to set “just and reasonable” rates. Rate base is the depreciated original cost of the plant in service (net of contributions in aid of construction (“CIAC”) and advances in aid of construction (“AIAC”)), that has been determined to have been “prudently invested” and “used and useful”. The ACC also decides on an applicable capital structure based on actual or hypothetical analyses. The ACC determines a “fair rate of return” on that rate base which includes the actual cost of debt and an established return on equity. The overall revenue requirement for rate making purposes is established by multiplying the rate of return on rate base by the rate base, and adding “prudently” incurred operating expenses for the test year, depreciation and any applicable pro forma adjustments.

To ensure an optimal combination of access to water and water conservation balanced with a fair rate of return for investors, GWRI’s water utility operating revenue is based on two components: a fixed fee and a consumption or volumetric fee. For GWRI’s water utilities, the fixed fee, or “basic service charge”, provides access to water for residential usage and has generally been set at a level to produce 40% to 60% of total revenue. The volumetric fee is based on the total volume of water supplied to a given customer after the minimum number of gallons, if any, covered by the basic service charge, multiplied by a price per gallon set by a tariff approved by the ACC. For all investor-owned water utilities, the ACC requires the establishment of inverted tier conservation oriented rates, meaning that the price of water increases as consumption increases. For wastewater utilities, wastewater collection and treatment can be based on volumetric or fixed fees. At GWRI’s wastewater utilities, service is based solely on a fixed fee, determined by the size of the water meter installed. Recycled water is sold on a volumetric basis with no fixed fee component.

To obtain approval for a change in rates, GWRI’s utilities must file rate cases with the ACC. Rate cases and other rate-related proceedings can take a year or more to complete. There is therefore frequently a delay, or regulatory lag, between the time of a capital investment or incurrence of an operating expense increase and when those costs are reflected in rates. GWRI’s rate case management program includes a proactive approach to rate design and management of rate case applications to mitigate the risk of regulatory lag. The Company maintains a rate model that dynamically reviews changes in current connection growth and expense structure combined with capital invested to determine the precise timing of filing for a rate increase. In normal conditions, it would not be uncommon to see the Company file for a rate increase every three years based on year one being the test year, year two being the rate case filing year and year three being the rate case award year.

### ***Recent Rate Case Activities***

On September 15, 2010, the ACC issued its rate decision (the “2010 Regulatory Rate Decision”) for the rate cases filed in February 2009 for the following GWRI utilities: Santa Cruz Water Company (“Santa Cruz”), Palo Verde Utilities Company (“Palo Verde”), Valencia Water Company, Inc. (“Valencia”), Water Utility of Greater Buckeye (“Greater Buckeye”), Water Utility of Greater Tonopah (“Greater Tonopah”) and Willow Valley Water Company (“Willow Valley”). The ACC established new rates for the utilities resulting in approximately \$9.6 million of additional annual revenues retroactive to August 1, 2010, including a phase-in of rates for Palo Verde on January 1, 2011 and January 1, 2012. The ACC established new rates based on connections during the 2008 test year for the



recovery of reasonable costs incurred by the utilities. Such rate changes increased rates for water and wastewater services for all but one of GWRI's utilities, Greater Tonopah (for which rates were reduced), resulting in an overall 47% increase over previous rates. For a discussion of the impacts of the rate decision, refer to Note 3 to GWRI's audited consolidated financial statements for the year ended December 31, 2011.

On July 11, 2012, we filed applications with the ACC for increased rates for seven of our utilities. These applications were determined sufficient in November 2012 by the ACC Staff. The evaluation process, including a formal rate hearing, is expected to take approximately 12 months from the time the ACC deemed the filings sufficient. After the hearing, the ACC will issue its decision and the new rates will become effective.

The current revenue requirement for these utilities was set in a rate case that concluded in 2010 and was based on a 2008 historic test year. Since that time, certain costs related to utility operations have increased. The Company has also continued to make the necessary capital improvements to maintain industry-leading performance for compliant operations, reliability, customer service, and critical water resource management. The rate applications request an adjustment to the revenue requirements for all seven utilities representing a collective rate increase of approximately 28%, or approximately \$8.4 million, of annualized revenues over 2012. We expect that the rate increase will be phased-in over a two to three year period.

### ***Infrastructure Investment***

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

GWRI has made significant capital investments in its territories within the last seven years; and because the infrastructure is new, significant growth capital will not be required for some time. GWRI estimates that capital expenditures of the Regulated business will total approximately \$1.5 to \$2.0 million annually for the foreseeable future. Nevertheless, GWRI will repair and replace existing infrastructure as needed. Non-growth capital investments are needed on an ongoing basis to comply with existing and new regulations, to renew treatment and network assets as they age, to enhance system reliability, and to provide security and quality of service. The need for continuous investment can present a challenge due to the potential for regulatory lag described above.

### ***Production and Treatment Costs***

GWRI's water and wastewater services require significant production inputs and result in significant production costs. Although GWRI is permitted to recover these costs through the rates it charges, regulatory lag can decrease GWRI's margins and earnings if production costs or other operating expenses increase significantly before GWRI is able to recover them through increased rates. GWRI's most significant production costs include labor and chemicals used to treat water and wastewater, and power, which is used to operate pumps and other equipment. Power and chemical costs can be volatile and all of GWRI's production costs have increased in recent years. However, GWRI employs a variety of technologies and methodologies to reduce costs and maximize operational efficiencies. GWRI deploys its integrated TWM approach both to conserve water and to maximize its total economic and social value. For power alone, GWRI has been successful in minimizing the rise in power costs by vigilantly focusing on timing and duration of power requirements. Additionally, with TWM and the use of recycled water, there are significant treatment costs and power savings that can be realized due to the fact that smaller volumes of water are required for potable use. The old paradigm requires that all water be treated to potable standards irrespective of use. TWM



focuses on the right water for the right use. Potable water is needed for consumption and recycled water is acceptable for non-potable uses such as irrigation and toilet flushing. Non-potable water does not need to be treated for arsenic removal or perchlorate, or for any future human health-based contaminant.

### ***Weather and Seasonality***

GWRI's water systems generally experience higher demand in the summer due to the warmer temperatures and increased usage by customers for irrigation and other outdoor uses. However, summer weather that is cooler or wetter than average generally suppresses customer water demand and can have a downward effect on GWRI's operating revenue and operating income. The limited geographic diversity of GWRI's service areas could make the results of GWRI's operations more sensitive to the effect of local weather extremes.

The second and third quarters of the year are generally those in which water services revenue and wastewater services revenue are highest. Accordingly, interim results should not be considered representative of the results of a full year.

### **Selected Financial Information**

The following contains selected financial information of GWRI's financial position as of December 31, 2012, 2011 and 2010 (in thousands of US\$):

	<b>December 31, 2012</b>	<b>December 31, 2011</b>	<b>December 31, 2010</b>
<b>ASSETS:</b>			
Net property, plant and equipment.....	\$ 260,236	\$ 265,948	\$ 272,493
Current assets .....	8,750	9,138	14,602
Other assets .....	30,411	55,536	54,367
Total Assets.....	<u>\$ 299,397</u>	<u>\$ 330,622</u>	<u>\$ 341,462</u>
<b>LIABILITIES:</b>			
Current liabilities .....	\$ 14,707	\$ 21,570	\$ 28,077
Noncurrent liabilities.....	311,254	296,690	301,767
Total Liabilities .....	325,961	318,260	329,844
SHAREHOLDERS' EQUITY (DEFICIT) .....	(26,564)	12,362	11,618
Total Liabilities and Shareholders' Equity (Deficit).....	<u>\$ 299,397</u>	<u>\$ 330,622</u>	<u>\$ 341,462</u>

The following contains selected financial information of GWRI's results of operations for the years ended December 31, 2012, 2011 and 2010 (in thousands of US\$):

	<b>Years Ended December 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>
Revenues.....	\$ 33,538	\$ 36,405	\$ 28,526
Operating expenses.....	32,550	32,836	104,338
Operating income .....	988	3,569	(75,812)
Total other income (expense).....	(8,802)	(8,849)	(13,076)
Loss before income taxes.....	(7,814)	(5,280)	(88,888)
Income tax (expense) benefit .....	(30,667)	1,972	3,847
Net loss.....	<u>\$ (38,481)</u>	<u>\$ (3,308)</u>	<u>\$ (85,041)</u>

Our results of operations for the year ended December 31, 2012 was impacted by a \$33.7 million charge attributed to a valuation allowance recorded against the Company's net deferred tax assets in 2012 (See Note 8 to GWRI's consolidated financial statements for the year ended December 31, 2012). Loss, excluding this charge, totaled \$4.6 million for the year ended December 31, 2012. Our results of operations for the year ended December 31, 2010 was impacted by a \$24.0 million goodwill impairment charge recorded during the year and a \$55.2 million regulatory charge recorded as a result of the 2010 Regulatory Rate Decision.

The recording of the valuation allowance in 2012 was made as a result of a U.S. GAAP accounting standard that considers historical results and existing contracts to determine whether an allowance should be recorded against the deferred tax asset. The deferred tax assets are still preserved for the purposes of the Company's tax returns and the allowance may be reduced when profitability is achieved as a result of new contracts, as a result of increases in utility rates from the pending rate case, or cost cutting measures taken by the Company. The valuation allowance had no impact on the Company's cash flows and we continue to believe in the long-term growth and profitability of the Company.

### Comparison of Results of Operations for the Years Ended December 31, 2012 and 2011

**Revenues** – The following table summarizes GWRI's revenues for the years ended December 31, 2012 and 2011 (in thousands of US\$).

	Years Ended December 31,	
	2012	2011
Water services.....	\$ 17,417	\$ 17,130
Wastewater and recycled water services.....	13,244	11,412
Unregulated revenues .....	2,877	7,863
Total revenues.....	\$ 33,538	\$ 36,405

Total revenues decreased \$2.9 million, or 7.9%, for the year ended December 31, 2012 compared with the year ended December 31, 2011. The decrease was primarily attributed to the Company recognizing \$4.6 million of FATHOM<sup>TM</sup> implementation revenue and \$1.4 million of revenue related to the sale of contractual rights during the year ended December 31, 2011, compared to \$385,000 of FATHOM<sup>TM</sup> implementation revenue and \$132,000 revenue related to the sale of contractual rights for the year ended December 31, 2012. This decrease was partially offset by the increase of \$2.1 million, or 7.4%, in revenues from water, wastewater and recycled water services, primarily due to the rate increase associated with of the final phase-in of rates pursuant to the 2010 Regulatory Rate Decision, coupled with the effects of a higher number of active service connections.

*Water Services* – Water services revenues increased \$287,000, or 1.7%, to \$17.4 million for the year ended December 31, 2012 compared with the same period in 2011.

Active water connections increased 3.3% to 24,681 at December 31, 2012 from 23,900 at December 31, 2011. Water consumption remained unchanged over the periods, totaling 2.8 billion gallons for the years ended December 31, 2012 and 2011. Despite the higher number of service connections, higher precipitation levels during 2012 compared with 2011 created weaker demand for water and resulted in flat consumption volumes. Water services revenues based on consumption increased to \$7.5 million for the year ended December 31, 2012 from \$7.2 million in 2011. The increase in such revenue is attributed to higher consumption from commercial and construction customers whose increased consumption levels placed them into tiers subjected to higher rates.

Water services revenue, excluding miscellaneous charges, associated with the basic service charge remained relatively flat, totaling \$9.4 million for both of the years ended December 31, 2012 and 2011.

*Wastewater and Recycled Water Services* – Wastewater and recycled water services revenues increased \$1.8 million, or 16.1%, to \$13.2 million for the year ended December 31, 2012 compared to \$11.4 million in 2011 due primarily to the higher rates that we are able to charge customers effective January 1, 2012, combined with the additional fees arising from increased active service connections. Active wastewater and recycled water connections increased 3.1% to 16,327 at December 31, 2012 from 15,831 at December 31, 2011.

Wastewater revenue, excluding miscellaneous charges, which is billed and recognized at a flat rate per connection, totaled \$12.7 million for the year ended December 31, 2012 compared to \$10.8 million for the year ended December 31, 2011. The increase in revenue reflects the higher rates and the higher number of active connections mentioned above.

Recycled water revenue, which is based on gallons delivered, remained relatively unchanged, increasing \$3,000, or 1.2%, to \$307,000 for the year ended December 31, 2012 compared to \$304,000 for the year ended December 31, 2011. The volume of recycled water delivered increased slightly to 539 million gallons for the year ended December 31, 2012 from 528 million gallons for the year ended December 31, 2011 due to the increased number of customers.

*Unregulated Revenues* – Unregulated revenues totaled \$2.9 million in the year ended December 31, 2012 compared to \$7.9 million in the year ended December 31, 2011. Unregulated revenues primarily consist of revenues generated from customers of GWRI's FATHOM™ business. The decrease was primarily attributed to the Company recognizing \$4.6 million of FATHOM™ implementation revenue for the year ended December 31, 2011 compared to \$385,000 of such revenue for the year ended December 31, 2012.

Additionally as part of Unregulated revenues, GWRI recognized \$1.4 million of revenue for the year ended December 31, 2011 related to the sale of certain contractual rights to receive future refunds associated with line extension agreements of the Company's regulated utilities. This compares to \$132,000 of such revenue recognized in the year ended December 31, 2012.

Finally, in 2012 we began performing engineering services for third parties which we recognized on a percentage of completion basis. Engineering service revenue totaled \$86,000 during the year ended December 31, 2012.

**Operating Expenses** – Operating expenses decreased \$286,000, or 0.9%, to \$32.6 million for the year ended December 31, 2012 from \$32.8 million for the year ended December 31, 2011.

During the second half of 2011, in connection with our annual 2012 budgeting process and evaluation of our corporate cost allocation methodology, we performed a review of how certain expenses were classified for financial reporting. The Company has consistently viewed operations and maintenance expense as the category reflecting the costs associated with generating revenues. Prior to performing this evaluation, certain costs, including those relating to our billing and customer service departments, were classified in general and administrative expense in our statement of operations. However, based on our assessment, and particularly in light of the Company serving an increasing number of third party FATHOM™ clients to whom services such as billing and customer service are the services actually being sold, the Company made the decision that certain of the costs historically presented in general and administrative expenses would now be presented as a component of operations and maintenance expense. We recognize this decision required significant judgement, but believe that the change in the categorization of the particular costs is appropriate and a better reflection of the Company's current business activities.

The following table summarizes GWRI's operating expenses for the years ended December 31, 2012 and 2011 (as reported) (in thousands of US\$), including amounts reclassified to conform to the current presentation discussed above:

	Years Ended December 31,		
	2012	2011 <sup>(1)</sup> (as reclassified)	2011 (as reported)
Operations and maintenance .....	\$ 11,994	\$ 13,245	\$ 12,157
General and administrative .....	9,657	9,104	10,192
Depreciation .....	10,899	10,487	10,487
Total operating expenses .....	<u>\$ 32,550</u>	<u>\$ 32,836</u>	<u>\$ 32,836</u>

(1) Certain previously reported amounts have been reclassified to conform to the current presentation discussed above relating to the classification of cost in general and administrative expense versus operations and maintenance.

To improve comparability between periods for operations and maintenance expenses, and general and administrative expenses, the following discussion is based on the amounts presented in the table above in the column "2011 (as reclassified)" when reference is made to the year ended December 31, 2011.

*Operations and Maintenance* – Operations and maintenance costs, consisting of personnel costs, production costs (primarily chemicals and purchased power), maintenance costs, costs associated with FATHOM™ implementations and recurring services, and property tax, decreased \$1.3 million, or 9.4%, for the year ended December 31, 2012 compared to the year ended December 31, 2011.

Expenses associated with FATHOM™ implementations decreased \$2.5 million to \$0.3 million for the year ended December 31, 2012 from \$2.8 million for the year ended December 31, 2011. During 2011, the Company had AMI implementation activities with the Cities of Grass Valley and Covina, whereby significant costs were incurred and recognized in connection with the related recognition of AMI implementation revenue. During 2012, the Company had no AMI implementation activities. Implementation expenses recorded during 2012 primarily related to projects performed for Thames Water and the Cities of Corpus Christi, TX, and El Cajon.

This decrease attributed to FATHOM™ implementation expenses was partially offset by a \$0.9 million increase in personnel costs, which was primarily attributable to increased headcount in support of the FATHOM™ business. Postage, telecommunication, banking costs, rent and other variable costs associated with servicing additional FATHOM™ customers increased as well over the period.

Our Regulated Utilities experienced an increase in power and chemical costs, primarily reflecting unplanned costs required at our Palo Verde wastewater facility to address an illicit dumping event and a flood and infiltration event that occurred during 2012. Additionally, we experienced an increased level of property taxes and repairs and maintenance expenses during 2012.

*General and Administrative* – General and administrative costs include the day-to-day expenses of office operations, including personnel costs, legal and other professional fees, insurance and regulatory fees. These costs increased \$553,000, or 6.1%, during the year ended December 31, 2012 compared to the year ended December 31, 2011. The increase was mainly driven by a \$555,000, or 13.5%, increase in our personnel and related costs, which was primarily attributed to higher incentive compensation and higher labor costs within the Company's IT and sales and marketing departments during 2012 compared to 2011.

Professional fees, which include legal and accounting costs, increased \$91,000 to \$1.3 million for the year ended December 31, 2012, compared to 2011. The increase primarily relates to a \$190,000 increase in accounting fees incurred in 2012 for performing quarterly reviews and assessing significant accounting and tax matters. The increase was partially offset by a \$145,000 decrease in legal costs. Legal fees related to the dissolution of our Francisco Grande utility totaled \$40,000 in the year ended December 31, 2011, and \$0 in 2012. Legal expense associated with the ARV/Fluid Solution litigation exceeded \$100,000 in 2011 but were \$0 in 2012.

Promotional costs related to GWRI's FATHOM™ business decreased \$220,000 to \$322,000 during the year ended December 31, 2012 compared to the year ended December 31, 2011, primarily reflecting reduced training and advertizing costs.

*Depreciation* – Depreciation expense increased by \$412,000, or 3.9%, to \$10.9 million for the year ended December 31, 2012 compared to the year ended December 31, 2011. The increase reflects the impact of additional fixed assets placed into service over the past 24 months.

**Other Income (Expense)** – Other income (expense), primarily consisting of interest expense, remained relatively flat at \$8.8 million. Interest expense increased \$657,000 during the year ended December 31, 2012 compared to the prior year, due to a higher average debt balance and due to a \$602,000 write-off of debt issuance costs in connection with the extinguishment of the related-party promissory note, the \$7.0 million Regions term loan, and another previously contemplated bond refinancing.

Offsetting the effect of higher interest expense, other income increased during the year ended December 31, 2012 due to \$719,000 of interest received from a developer in connection with the SNR/NWP arbitration decision (see Note 12 to GWRI's consolidated financial statements for the year ended December 31, 2012).

**Income Tax Benefit (Expense)** – For the year ended December 31, 2012, the Company recognized income tax expense in the amount of \$30.7 million, compared to an income tax benefit of \$2.0 million for the year ended December 31, 2011. This difference is attributable to \$32.8 the valuation allowance recorded against the Company's net deferred tax assets effective June 30, 2012. At December 31, 2012, the valuation allowance totaled approximately \$33.7 million. Any new deferred tax assets that arise from net operating loss carryforwards will also be reserved (see Note 8 to GWRI's consolidated financial statements for the year ended December 31, 2012).

**Net Loss** – The Company's net loss totaled \$38.5 million for the year ended December 31, 2012 compared to a net loss of \$3.3 million for the year ended December 31, 2011. This difference was primarily due to the valuation allowance recorded on the net deferred tax asset mentioned above.

**EBITDA** – EBITDA totaled \$12.6 million for the year ended December 31, 2012 compared to \$14.1 million for the year ended December 31, 2011. For additional discussion, refer to the sections *Revenues* and *Operating Expenses* above.

A reconciliation of Net Loss to EBITDA in the years ended December 31, 2012 and 2011 is as follows (in thousands of US\$):

	Years Ended December 31,	
	2012	2011
<b>Net Loss</b> .....	<b>\$ (38,481)</b>	<b>\$ (3,308)</b>
Income tax expense (benefit) .....	30,667	(1,972)
Interest income .....	(6)	(2)
Interest expense .....	9,565	8,908
Depreciation .....	10,899	10,487
<b>EBITDA<sup>(1)</sup></b> .....	<b>\$ 12,644</b>	<b>\$ 14,113</b>

- (1) EBITDA is defined as income or loss before interest, income taxes, depreciation and amortization. EBITDA is not a recognized measure under U.S. GAAP and does not have a standardized meaning prescribed by U.S. GAAP. Therefore, EBITDA may not be comparable to similar measures presented by other companies. The table above reconciles EBITDA to net income (loss). See “Cautionary Statements Regarding Non-GAAP Measures” for further information regarding EBITDA.

**Net Loss and EBITDA Per Share Information** – The common stock of GWRI is not publically traded and reporting per share information is not a required disclosure. However, management believes that net earnings (loss) per share and EBITDA per share data may be useful to some users of the financial statements as those users make decisions related to GWRC, which holds an approximate 48.1% interest in GWRI. The following table summarizes such information for the years ended December 31, 2012 and 2011 (amounts in thousands of US\$, except share and per share data):

	Net Loss	EBITDA
Amount for the year ended December 31, 2012.....	\$ (38,481)	\$ 12,644
Weighted average number of GWRI shares outstanding during the year ended December 31, 2012 .....	182,050	182,050
GWRI per share amount <sup>(1)</sup> .....	<u>\$ (211.38)</u>	<u>\$ 69.45</u>
GWRI per share amount, excluding valuation allowance <sup>(2)</sup> .....	\$ (26.44)	\$ 69.45
	Net Loss	EBITDA
Amount for the year ended December 31, 2011.....	\$ (3,308)	\$ 14,113
Weighted average number of GWRI shares outstanding during the year ended December 31, 2011 .....	181,629	181,629
GWRI per share amount <sup>(1)</sup> .....	<u>\$ (18.21)</u>	<u>\$ 77.70</u>

- (1) Each share of GWRI is approximately equivalent to 100 common shares of GWRC. Therefore, GWRI’s net loss per share and EBITDA per share amounts in terms of GWRC’s common shares is approximately \$(2.11) and \$0.69 for 2012, respectively, and approximately \$(0.18) and \$0.78 for 2011, respectively. EBITDA and EBITDA per share data are not U.S. GAAP measures.

- (2) Excluding the effect of the valuation allowance, which increased income tax expense, GWRI’s net loss and loss per share amount in terms of GWRC’s common shares totaled \$(4,813,000) and approximately \$(0.26), respectively, for the year ended December 31, 2012.

**Quarterly Results** – Our results of operations have varied and may continue to vary from quarter to quarter and are not necessarily indicative of the results of any future period. The 2010 Regulatory Rate Decision had a significant impact on our business, including GWRI charging generally higher rates to customers of the Regulated division, effective August 1, 2010, January 1, 2011 and January 1, 2012.

We believe that we have included all adjustments, consisting only of normal recurring adjustments necessary for a fair statement of our quarterly data. You should read our quarterly data in conjunction with our consolidated financial statements and the related notes.

Operating results of our Regulated business are subject to significant seasonality. GWRI's water systems generally experience higher demand in the summer due to the warmer temperatures and increased usage by customers for irrigation and other outdoor uses. Accordingly, the second and third quarters of the year are generally those in which water services revenue and recycled water revenue are highest. Nevertheless, cooler or wetter weather can have a downward effect on our operating results. On average, temperatures were slightly higher and rainfall was higher in 2012 compared with 2011.

We also believe the proposal and contracting process for new FATHOM<sup>TM</sup> customers is subject to seasonality. Specifically, the annual budgeting process of most municipalities occurs during their fourth fiscal quarter, which typically ends June 30<sup>th</sup>. This budgeting process is complicated and time-intensive for municipalities, and many potential FATHOM<sup>TM</sup> customers have indicated to us that, during this annual budgeting process, fewer resources are available to evaluate and obtain approval to acquire FATHOM<sup>TM</sup> services.



The following table sets forth unaudited consolidated financial data for the last eight quarters ended December 31, 2012 (in thousands of US\$). This financial information has been derived from the unaudited interim financial statements prepared by and is the responsibility of the Company's management.

### As Reported:

	2012				2011			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
<b>REVENUES:</b>								
Water services.....	\$ 4,156	\$ 4,863	\$ 4,844	\$ 3,554	\$ 3,815	\$ 5,394	\$ 4,497	\$ 3,424
Wastewater and recycled water services.....	3,331	3,328	3,353	3,232	2,903	2,872	2,866	2,771
Unregulated revenues.....	937	829	572	539	1,016	1,885	1,991	2,971
Total revenues.....	8,424	9,020	8,769	7,325	7,734	10,151	9,354	9,166
<b>OPERATING EXPENSES:</b>								
Operations and maintenance.....	2,862	3,276	2,919	2,937	2,767	3,164	3,151	3,075
General and administrative.....	2,362	2,178	2,457	2,660	2,238	2,384	2,678	2,892
Depreciation .....	2,866	2,662	2,706	2,665	2,738	2,557	2,580	2,612
Total operating expenses.....	8,090	8,116	8,082	8,262	7,743	8,105	8,409	8,579
OPERATING INCOME (LOSS).....	334	904	687	(937)	(9)	2,046	945	587
<b>OTHER INCOME (EXPENSE):</b>								
Interest income.....	5	1	-	-	-	-	-	2
Interest expense.....	(2,085)	(2,245)	(3,005)	(2,230)	(2,194)	(2,196)	(2,202)	(2,316)
Other .....	(14)	723	54	(6)	2	(8)	23	40
Total other income (expense) .....	(2,094)	(1,521)	(2,951)	(2,236)	(2,192)	(2,204)	(2,179)	(2,274)
INCOME (LOSS) BEFORE INCOME TAXES .....	(1,760)	(617)	(2,264)	(3,173)	(2,201)	(158)	(1,234)	(1,687)
INCOME TAX (EXPENSE) BENEFIT .....	(6)	-	(31,885)	1,224	795	56	471	650
NET INCOME (LOSS) .....	\$ (1,766)	\$ (617)	\$ (34,149)	\$ (1,949)	\$ (1,406)	\$ (102)	\$ (763)	\$ (1,037)
INCOME (LOSS), EXCLUDING VALUATION ALLOWANCE .....	\$ (1,073)	\$ (397)	\$ (1,394)	\$ (1,949)	\$ (1,406)	\$ (102)	\$ (763)	\$ (1,037)

To improve comparability between periods for operations and maintenance, and general and administrative expenses, amounts for the quarters of 2011 in the following table are presented consistent with the “2011 (as reclassified)” amounts reflected in the first table in *Operating Expenses* above. The following table sets forth unaudited consolidated financial data for the last eight quarters ended December 31, 2012 (in thousands of US\$). This financial information has been prepared by and is the responsibility of the Company’s management.

**As Reclassified:**

	2012				2011			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
<b>REVENUES:</b>								
Water services .....	\$ 4,156	\$ 4,863	\$ 4,844	\$ 3,554	\$ 3,815	\$ 5,394	\$ 4,497	\$ 3,424
Wastewater and recycled water services .....	3,331	3,328	3,353	3,232	2,903	2,872	2,866	2,771
Unregulated revenues .....	937	829	572	539	1,016	1,885	1,991	2,971
Total revenues .....	8,424	9,020	8,769	7,325	7,734	10,151	9,354	9,166
<b>OPERATING EXPENSES:</b>								
Operations and maintenance .....	2,862	3,276	2,919	2,937	2,758	3,583	3,547	3,357
General and administrative .....	2,362	2,178	2,457	2,660	2,247	1,965	2,282	2,610
Depreciation .....	2,866	2,662	2,706	2,665	2,738	2,557	2,580	2,612
Total operating expenses .....	8,090	8,116	8,082	8,262	7,743	8,105	8,409	8,579
OPERATING INCOME (LOSS) .....	334	904	687	(937)	(9)	2,046	945	587
<b>OTHER INCOME (EXPENSE):</b>								
Interest income .....	5	1	-	-	-	-	-	2
Interest expense .....	(2,085)	(2,245)	(3,005)	(2,230)	(2,194)	(2,196)	(2,202)	(2,316)
Other .....	(14)	723	54	(6)	2	(8)	23	40
Total other income (expense) .....	(2,094)	(1,521)	(2,951)	(2,236)	(2,192)	(2,204)	(2,179)	(2,274)
INCOME (LOSS) BEFORE INCOME TAXES .....	(1,760)	(617)	(2,264)	(3,173)	(2,201)	(158)	(1,234)	(1,687)
INCOME TAX (EXPENSE) BENEFIT .....	(6)	-	(31,885)	1,224	795	56	471	650
NET INCOME (LOSS) .....	\$ (1,766)	\$ (617)	\$ (34,149)	\$ (1,949)	\$ (1,406)	\$ (102)	\$ (763)	\$ (1,037)
<b>INCOME (LOSS), EXCLUDING VALUATION ALLOWANCE .....</b>								
	\$ (1,073)	\$ (397)	\$ (1,394)	\$ (1,949)	\$ (1,406)	\$ (102)	\$ (763)	\$ (1,037)

## Comparison of Results of Operations for the Fourth Quarter of 2012 versus the Fourth Quarter of 2011

**Revenues** – The following table summarizes GWRI’s revenues for the three months ended December 31, 2012 and 2011 (in thousands of US\$).

	Three Months Ended December 31,	
	2012	2011
Water services.....	\$ 4,156	\$ 3,815
Wastewater and recycled water services.....	3,331	2,903
Unregulated revenues .....	937	1,016
Total revenues .....	<u>\$ 8,424</u>	<u>\$ 7,734</u>

Total revenues increased \$0.7 million, or 8.9%, for the three months ended December 31, 2012 compared with the three months ended December 31, 2011. The increase was primarily attributed to an increase in revenues of \$0.3 million from water service and of \$0.4 million from wastewater and recycled water services as further discussed below.

*Water Services* – Water services revenues increased \$0.3 million, or 8.9%, to \$4.2 million for the three months ended December 31, 2012 compared with the same period in 2011. Active water connections increased 3.3% to 24,681 at December 31, 2012 from 23,900 at December 31, 2011.

Water consumption increased to 627 million gallons for the three months ended December 31, 2012 from 499 million gallons for the three months ended December 31, 2011. Water services revenue based on consumption totaled \$1.6 million for the three months ended December 31, 2012 compared to \$1.3 million for the three months ended December 31, 2011. The increase in water consumption was due to the higher number of service connections, lower precipitation levels and higher temperatures experienced during the three months ended December 31, 2012 as compared to the same period in 2011.

Water services revenue, excluding miscellaneous charges, associated with the basic service charge remained relatively consistent at approximately \$2.4 million for the three months ended December 31, 2012 and 2011.

*Wastewater and Recycled Water Services* – Wastewater and recycled water services revenues increased \$0.4 million, or 14.7%, for the three months ended December 31, 2012 compared with the same period in 2011 due primarily to the higher rates that we were able to charge customers effective January 1, 2012, combined with the additional fees arising from increased active service connections. Active wastewater and recycled water connections increased 3.1% to 16,327 at December 31, 2012 from 15,831 at December 31, 2011.

Wastewater revenue, excluding miscellaneous charges, which is billed and recognized at a flat rate per connection, totaled \$3.2 million for the three months ended December 31, 2012 compared to \$2.8 million for the three months ended December 31, 2011. The increase in revenue reflects the higher rates and the higher number of active connections mentioned above.

Recycled water revenue, which is based on gallons delivered, totaled approximately \$81,000 for the three months ended December 31, 2012 compared to \$71,000 for the three months ended December 31, 2011. The volume of recycled water delivered slightly increased to 143 million gallons for the three months ended December 31, 2012 from 124 million gallons for the three months ended December 31, 2011. The increase in recycled water delivered was due to the higher number service connections, lower precipitation levels and higher temperatures experienced during the three months ended December 31, 2012 compared with the three months ended December 31, 2011.

**Unregulated Revenues** – Unregulated revenues decreased \$79,000, or 7.8% for the three months ended December 31, 2012 compared with the same period in 2011. Unregulated revenues primarily consist of revenues generated from customers of our FATHOM™ business.

As part of unregulated revenues, GWRI recognized revenue from the sale of certain contractual rights to receive future refunds associated with line extension agreements of GWRI's regulated utilities. Such sales totaled \$132,000 during the three months ended December 31, 2012 compared to \$379,000 during the three months ended December 31, 2011. This decrease was partially offset by an increase of \$49,000 in FATHOM™ nonrecurring revenue during the three months ended December 31, 2012, and a \$40,000 increase in recurring FATHOM™ revenues during the period due to additional FATHOM™ clients.

Additionally, in 2012 we began performing engineering services for third parties which we recognized on a percentage of completion basis. Engineering service revenue totaled \$86,000 during the three months ended December 31, 2012.

**Operating Expenses** – Operating expenses increased \$347,000, or 4.5%, to \$8.1 million for the three months ended December 31, 2012 as compared with \$7.7 million in the same period of 2011.

During the second half of 2011, in connection with our annual 2012 budgeting process and evaluation of our corporate cost allocation methodology, we performed a review of how certain expenses were classified for financial reporting. The Company has consistently viewed operations and maintenance expense as the category reflecting the costs associated with generating revenues. Prior to performing this evaluation, certain costs, including those relating to our billing and customer service departments, were classified in general and administrative expense in our statement of operations. However, based on our assessment, and particularly in light of the Company serving an increasing number of third party FATHOM™ clients to whom services such as billing and customer service are the services actually being sold, the Company made the decision that certain of the costs historically presented in general and administrative expenses would now be presented as a component of operations and maintenance expense. We recognize this decision required significant judgement, but believe that the change in the categorization of the particular costs is appropriate and a better reflection of the Company's current business activities.

The following table summarizes GWRI's operating expenses for the three months ended December 31, 2012 and 2011 (as reported) (in thousands of US\$), including amounts reclassified to conform to the current presentation discussed above:

	Three Months Ended December 31,		
	2012	2011 <sup>(1)</sup> (as reclassified)	2011 (as reported)
Operations and maintenance .....	\$ 2,862	\$ 2,758	\$ 2,767
General and administrative .....	2,362	2,247	2,238
Depreciation.....	2,866	2,738	2,738
Total operating expenses .....	<u>\$ 8,090</u>	<u>\$ 7,743</u>	<u>\$ 7,743</u>

(1) Certain previously reported amounts have been reclassified to conform to the current presentation discussed above related to the classification of costs within general and administrative expense versus operations and maintenance.

To improve comparability between periods for operations and maintenance, and general and administrative expenses, the following discussion is based on the amounts presented in the table above in the column "2011 (as reclassified)" when reference is made to the three months ended December 31, 2011.

*Operations and Maintenance* – Operations and maintenance costs, consisting of personnel costs, production costs (primarily chemicals and purchased power), maintenance costs, costs associated with FATHOM™ implementations and recurring services, and property tax, increased \$104,000, or 3.8%, for the three months ended December 31, 2012 compared to the three months ended December 31, 2011.

Total personnel costs increased \$52,000, or 6.5%, in the three months ended December 31, 2012 as compared to the fourth quarter of 2011. The increase is primarily attributed to incentive compensation and the increased average headcount in 2012 compared with the fourth quarter of 2011 due to additional employees supporting the FATHOM™ business, including an increase in full-time employees and a decrease in the use of contract labor for FATHOM™. Contract labor for FATHOM™ decreased as more of the personnel supporting FATHOM™ became full-time employees.

Postage, banking costs, and other variable costs associated with servicing additional FATHOM™ customers increased in the 2012 period compared to the 2011 period.

Our Regulated Utilities experienced an increase in power and chemical costs, partially as a result of higher water consumption levels, but also due to the unplanned costs required at our Palo Verde wastewater facility to address an illicit dumping event and a flood and infiltration event that occurred during 2012. Additionally, we experienced an increased level of property taxes and repairs and maintenance expenses during the three months ended December 31, 2012 compared to the three months ended December 31, 2011.

*General and Administrative* – General and administrative costs include the day-to-day expenses of office operations; including personnel costs, legal and other professional fees, insurance and regulatory fees. These costs increased \$115,000, or 5.1%, during the three months ended December 31, 2012 compared to the three months ended December 31, 2011. The increase was mainly driven by a \$86,000, or 9.7% increase in personnel and related costs, which totaled \$1.0 million for the three months ended December 31, 2012.

GWRI's professional fees, which include legal and accounting costs, increased \$164,000, or 75.2%, to \$382,000 for the three months ended December 31, 2012, compared to the same period in 2011. The increase was primarily driven by higher accounting fees resulting from our independent auditors performing quarterly reviews during 2012, while quarterly reviews were not performed during 2011. General legal expense also increased modestly during the three months ended December 31, 2012 compared to the three months ended December 31, 2011.

Promotional costs, which primarily related to GWRI's FATHOM™ business, decreased \$109,000, or 38.7%, to \$172,000 during the three months ended December 31, 2012 compared to \$281,000 for the three months ended December 31, 2011, primarily reflecting reduced training and marketing costs.

Contract labor supporting general and administrative activities increased \$49,000, or 89.0%, to \$104,000 during the three months ended December 31, 2012 compared to the three months ended December 31, 2011. The increase was mainly due to an additional IT consulting company utilized at the corporate office.

*Depreciation* – Depreciation expense increased \$128,000, or 4.7%, to \$2.9 million for the three months ended December 31, 2012 compared to the three months ended December 31, 2011. The increase reflects the impact of additional fixed assets placed into service during the last 15 months.

**Other Income (Expense)** – Other income (expense) primarily consists of interest expense. Interest expense decreased \$109,000, or 5.0%, in the three months ended December 31, 2012 compared to the three months ended December 31, 2011. The decrease is primarily attributed to the Company's paying off the WMC purchase liability

in 2012, resulting in lower interest expense during the three months ended December 31, 2012 compared with the same period in 2011. In addition, a reduction of \$81,000 in interest expense was recorded during the three months ended December 31, 2012 related to the mark-to-market adjustment on our variable rate interest rate cap agreements.

While our average debt balance has increased over the period, interest rates on the additional debt is more favorable to the Company. Our higher debt load and our lower interest rates were factors that generally offset one another during the period.

**Income Tax Benefit (Expense)** – The Company recorded income tax expense of \$6,000 for the three months ended December 31, 2012, compared to an income tax benefit of \$795,000 for the three months ended December 31, 2011. Effective June 30, 2012, a valuation allowance is automatically established against any new deferred tax assets that arise from net operating loss carryforwards generated (see Note 8 to GWRI’s consolidated financial statements for the year ended December 31, 2012).

**Net Loss** – The Company’s net loss totaled \$1.8 million for the three months ended December 31, 2012 compared to a net loss of \$1.4 million for the three months ended December 31, 2011. This difference was due to several factors as mentioned above.

**EBITDA** – EBITDA totaled \$3.2 million for the three months ended December 31, 2012 compared to \$2.7 million for the three months ended December 31, 2011. For additional discussion, refer to the sections *Revenues* and *Operating Expenses* above.

A reconciliation of Net Loss to EBITDA in the three months ended December 31, 2012 and 2011 is as follows (in thousands of US\$):

	<b>Three Months Ended December 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>Net Loss</b> .....	<b>\$ (1,766)</b>	<b>\$ (1,406)</b>
Income tax expense (benefit) .....	6	(795)
Interest income .....	(5)	-
Interest expense .....	2,085	2,194
Depreciation .....	2,866	2,738
<b>EBITDA<sup>(1)</sup></b> .....	<b>\$ 3,186</b>	<b>\$ 2,731</b>

- (1) EBITDA is defined as income or loss before interest, income taxes, depreciation and amortization. EBITDA is not a recognized measure under U.S. GAAP and does not have a standardized meaning prescribed by U.S. GAAP. Therefore, EBITDA may not be comparable to similar measures presented by other companies. The table above reconciles EBITDA to net income (loss). See “Cautionary Statements Regarding Non-GAAP Measures” for further information regarding EBITDA.

**Net Loss and EBITDA Per Share Information** – The common stock of GWRI is not publically traded and reporting per share information is not a required disclosure. However, management believes that net earnings (loss) per share and EBITDA per share data may be useful to some users of the financial statements as those users make decisions related to GWRC, which holds an approximate 48.1% interest in GWRI. The following table summarizes such information for the three months ended December 31, 2012 and 2011 (amounts in thousands of US\$, except share and per share data):

	<u>Net Loss</u>	<u>EBITDA</u>
Amount for the three months ended December 31, 2012.....	\$ (1,766)	\$ 3,186
Weighted average number of GWRI shares outstanding during the three months ended December 31, 2012.....	182,050	182,050
GWRI per share amount <sup>(1)</sup> .....	<u>\$ (9.70)</u>	<u>\$ 17.50</u>
	<u>Net Loss</u>	<u>EBITDA</u>
Amount for the three months ended December 31, 2011.....	\$ (1,406)	\$ 2,731
Weighted average number of GWRI shares outstanding during the three months ended December 31, 2011 .....	182,050	182,050
GWRI per share amount <sup>(1)</sup> .....	<u>\$ (7.72)</u>	<u>\$ 15.00</u>

- (1) Each share of GWRI is approximately equivalent to 100 common shares of GWRC. Therefore, GWRI's net loss per share and EBITDA per share amounts in terms of GWRC's common shares is approximately \$(0.10) and \$0.18 for 2012, respectively, and approximately \$(0.08) and \$0.15 for 2011, respectively. EBITDA and EBITDA per share data are not U.S. GAAP measures as discussed above.



## Business Divisions

The following table summarizes GWRI's operating results by business division for the three months and years ended December 31, 2012 and 2011 (in thousands of US\$). To improve comparability between periods for operations and maintenance, and general and administrative expenses, amounts for the three months and year ended December 31, 2011 in the following table and discussion are presented consistent with the "2011 (as reclassified)" amounts reflected in the first table in *Operating Expenses* above.

	Regulated	Unregulated	Other	Eliminations	Total
<b>Three months ended December 31, 2012</b>					
Revenues .....					
Recurring .....	\$ 7,487	\$ 1,145	\$ -	\$ (430)	\$ 8,202
Non recurring .....	86	136	-	-	222
Operations and maintenance .....					
Recurring .....	1,850	884	-	-	2,734
Non recurring .....	36	92	-	-	128
General and administrative .....	1,761	1,031	-	(430)	2,362
Depreciation .....	2,412	454	-	-	2,866
Operating income (loss) .....	1,514	(1,180)	-	-	334
Other income (expense) .....	(32)	(24)	(2,038)	-	(2,094)
Income (loss) before income taxes .....	1,482	(1,204)	(2,038)	-	(1,760)
Income tax (expense) benefit .....	-	(6)	-	-	(6)
Net Income (Loss) .....	\$ 1,482	\$ (1,210)	\$ (2,038)	\$ -	\$ (1,766)
EBITDA .....	\$ 3,929	\$ (743)	\$ -	\$ -	\$ 3,186
	Regulated	Unregulated	Other	Eliminations	Total
<b>Three months ended December 31, 2011</b>					
Revenues .....					
Recurring .....	\$ 6,718	\$ 965	\$ -	\$ (417)	\$ 7,266
Non recurring .....	-	468	-	-	468
Operations and maintenance .....					
Recurring .....	1,590	1,108	-	-	2,698
Non recurring .....	-	60	-	-	60
General and administrative .....	1,607	1,057	-	(417)	2,247
Depreciation .....	2,457	281	-	-	2,738
Operating income .....	1,064	(1,073)	-	-	(9)
Other income (expense) .....	(277)	(2)	(1,913)	-	(2,192)
Income (loss) before income taxes .....	787	(1,075)	(1,913)	-	(2,201)
Income tax (expense) benefit .....	(119)	455	459	-	795
Net Income (Loss) .....	\$ 668	\$ (620)	\$ (1,454)	\$ -	\$ (1,406)
EBITDA .....	\$ 3,525	\$ (794)	\$ -	\$ -	\$ 2,731

	Regulated	Unregulated	Other	Eliminations	Total
<b>Year ended December 31, 2012</b>					
Revenues .....					
Recurring .....	\$ 30,661	\$ 3,974	\$ -	\$ (1,700)	\$ 32,935
Non recurring .....	86	517	-	-	603
Operations and maintenance .....					
Recurring .....	7,855	3,804	-	-	11,659
Non recurring .....	36	299	-	-	335
General and administrative .....	7,195	4,162	-	(1,700)	9,657
Depreciation .....	9,342	1,557	-	-	10,899
Operating income (loss) .....	6,319	(5,331)	-	-	988
Other income (expense) .....	(1,276)	(28)	(7,498)	-	(8,802)
Income (loss) before income taxes .....	5,043	(5,359)	(7,498)	-	(7,814)
Income tax (expense) benefit .....	(24,028)	(543)	(6,096)	-	(30,667)
Net Income (Loss) .....	\$ (18,985)	\$ (5,902)	\$ (13,594)	\$ -	\$ (38,481)
EBITDA .....	\$ 15,675	\$ (3,793)	\$ 762	\$ -	\$ 12,644
<b>Year ended December 31, 2011</b>					
Revenues .....					
Recurring .....	\$ 28,542	\$ 3,492	\$ -	\$ (1,651)	\$ 30,383
Non recurring .....	-	6,022	-	-	6,022
Operations and maintenance .....					
Recurring .....	6,749	3,673	-	-	10,422
Non recurring .....	-	2,823	-	-	2,823
General and administrative .....	6,979	3,776	-	(1,651)	9,104
Depreciation .....	9,560	927	-	-	10,487
Operating income .....	5,254	(1,685)	-	-	3,569
Other income (expense) .....	(1,117)	(5)	(7,727)	-	(8,849)
Income (loss) before income taxes .....	4,137	(1,690)	(7,727)	-	(5,280)
Income tax (expense) benefit .....	(1,595)	576	2,991	-	1,972
Net Income (Loss) .....	\$ 2,542	\$ (1,114)	\$ (4,736)	\$ -	\$ (3,308)
EBITDA .....	\$ 14,860	\$ (763)	\$ 16	\$ -	\$ 14,113

*Regulated* – Our Regulated division primarily consists of our water, wastewater and recycled water utilities which are regulated by the ACC. Revenues from our Regulated division increased \$0.9 million, or 11.5%, for the three months ended December 31, 2012 and increased \$2.2 million, or 7.7%, for the year ended December 31, 2012 compared with the same period in 2011. As discussed above, the primary factors impacting revenue and operating income were, (i) the rate increase phase-in pursuant to the 2010 Regulatory Rate Decision effective January 1, 2012, (ii) growth in the number of active service connections, (iii) higher precipitation during 2012 compared to 2011 resulting in a reduced demand for water.

Additionally, in 2012 we began performing engineering services for third parties which we recognized on a percentage of completion basis. Engineering service revenue totaled \$86,000 during the three months ended December 31, 2012. Engineering services are recorded as part of the Regulated division although the revenues we receive from customers for such services are not regulated by the ACC.

The operating expenses of the Regulated division increased \$405,000, or 7.2%, for the three months ended December 31, 2012 compared to the three months ended December 31, 2011, and increased \$1.1 million, or 4.9%, for the year ended December 31, 2012 compared to the year ended December 31, 2011. The division experienced a general increase of costs associated with servicing a higher number of accounts. Additionally, we experienced an increase in power and chemical costs, primarily reflecting unplanned costs required at our Palo Verde wastewater facility to address an illicit dumping event and a flood and infiltration event that occurred during 2012. Further, we experienced an increased level of property taxes and repairs and maintenance expenses during 2012.

*Unregulated* – Before intercompany eliminations, revenues of our Unregulated division totaled \$1.3 million and \$1.4 million in the three months ended December 31, 2012 and 2011, respectively, and \$4.5 million and \$9.5 million in the years ended December 31, 2012 and 2011, respectively. The Unregulated division primarily relates to the FATHOM™ business and the decrease in revenues was primarily attributed to the Company recognizing \$88,000 and \$4.6 million of FATHOM™ implementation revenue during the three months and year ended December 31, 2011, respectively, as compared to \$137,000 and \$385,000 of such revenue in the three months and year ended December 31, 2012, respectively.

The Company's Unregulated division considers the Regulated division as a FATHOM™ client and provides the same or similar services to the Regulated division as it provides third party FATHOM™ clients. Fees charged by the Unregulated division to the Regulated division remained relatively unchanged, totaling \$0.4 million and \$1.7 million for the three months and years ended December 31, 2012 and 2011, respectively. Whereas such amounts are included in revenues of the Unregulated division in the table above, these amounts have been eliminated in consolidation. Excluding intercompany revenues, recurring FATHOM™ revenues increased \$41,000, or 7.7%, to approximately \$569,000 for the three months ended December 31, 2012 and increased \$464,000, or 26.6%, to approximately \$2.2 million for the year ended December 31, 2012. The increase is attributed to the increased number of FATHOM™ clients and the increase in price we can contractually charge pursuant to inflation.

Non-recurring Unregulated revenues and operations and maintenance expense consists of those one-time revenues and costs related to FATHOM™ implementations. Nonrecurring revenues in 2011 primarily related to the City of Covina and the City of Grass Valley AMI implementations. During 2012, the Company had no AMI implementation activities. Non-recurring revenues and expenses recorded during 2012 primarily related to the non-recurring activities performed for Thames Water and with the cities of Corpus Christi, TX and El Cajon.

Additionally as part of non recurring revenues, we recognized \$379,000 and \$1.4 million of revenue for the three months and year ended December 31, 2011, respectively, related to the sale of certain contractual rights (see Note 1 in GWRI's 2012 audited consolidated financial statements). This compares to \$132,000 of such revenue in the three months and year ended December 31, 2012.

The Company periodically reviews its overhead allocation methodology to ensure business divisions are being allocated a reasonable share of corporate costs. These reviews take into consideration changes in the operations and environmental circumstances of the actual business units and attempt to allocate indirect costs of the Company to those business units in an equitable manner. When the Company filed for its last regulatory rate case, the Company purposely omitted specific overhead from the operating utilities to minimize the impact on rate payers due to the economic conditions occurring at that time. During 2011, the Company updated its allocation of overhead costs to

more appropriately assign such costs to each business division. This step ensured that the opportunity to recover appropriate overheads from rate payers in the future is preserved. There is no impact on the consolidated financial statements when the Company updates its overhead allocation.

*Other* – The Company’s “Other” category consists of all activities not classified under the Regulated and Unregulated divisions. During the periods presented, activities of this category included interest on parent company debt, which is not allocated to the other divisions.

### **Outstanding Share Data**

As of March 28, 2013, there were 182,050 shares of common stock of GWRI outstanding and options to acquire an additional 431 shares of common stock of GWRI.

### **Liquidity and Capital Resources**

The Company’s capital resources are principally provided by internally generated cash flows from operations as well as debt and equity financing. Additionally, GWRI’s regulated utility subsidiaries receive advances and contributions from customers, home builders and real estate developers to partially fund construction necessary to extend service to new areas. GWRI uses its capital resources to (i) fund operating costs, (ii) fund capital requirements, including construction expenditures, (iii) make debt and interest payments, and (iv) invest in new and existing ventures. GWRI’s utility subsidiaries operate in rate-regulated environments in which the amount of new investment recovery may be limited, and where such recovery takes place over an extended period of time, as recovery through rate increases is subject to regulatory lag. As a result of these factors, and as is typical for regulated water utilities, GWRI’s working capital, defined as current assets less current liabilities, as of December 31, 2012, is in a net deficit position.

As discussed in Notes 1 and 6 to GWRI’s 2012 consolidated financial statements, in March 2012 we made the final payment related to our WMC acquisition in the amount of \$11.9 million. A portion of this payment was provided through a related-party promissory note amortizing over a two year period. On March 22, 2012, we entered into a secured term credit facility with Regions Bank under which the Company borrowed \$7.0 million. This secured term credit facility allowed the Company to pay off its \$4.0 million revolving line of credit facility which matured on March 23, 2012, and extinguish the portion of the principal outstanding on the WMC acquisition payment which was not funded by the related-party promissory note.

On June 29, 2012, we raised \$25.0 million of new debt, which was primarily utilized to extinguish certain existing debt and accrued liabilities. The 2012 financings allowed us to consolidate our debt at a more attractive interest rate and lengthen the time period over which debt principal is amortized, which reduces our interest costs and improves our cash flow.

As of December 31, 2012, GWRI’s near-term cash expenditure obligations include approximately \$4.1 million of debt interest payments due June 2013 and approximately \$7.1 million of debt interest and principal payments due December 2013. While specific facts and circumstances could change, we believe we will be able to generate sufficient cash flows to meet our required debt service and operating and capital expenditures cash flow requirements. During 2013, we anticipate the receipt of the SNR award (see Note 12 to GWRI’s consolidated financial statements for the year ended December 31, 2012) and a favorable decision from the ACC in connection with our currently open rate case, whereby we can begin charging increased rates to our utility customers.

**Cash Flows from Operating Activities** – Cash flows from operating activities are used for operating needs and to meet capital expenditure requirements when excess operating cash flows are available. GWRI’s future cash flows

from operating activities will be affected by economic utility regulation, infrastructure investment, growth in service connections, customer usage of water, compliance with environmental health and safety standards, production costs, weather and seasonality, and the Company's ability to successfully grow its Unregulated business.

The following table provides a summary of the major items affecting GWRI's cash flows from operating activities for the years ended December 31, 2012 and 2011 (in thousands of US\$):

	<b>Years Ended December 31,</b>	
	<b>2012</b>	<b>2011</b>
Net loss .....	\$ (38,481)	\$ (3,308)
Add (subtract):		
Non-cash operating activities <sup>(1)</sup> .....	42,610	9,166
Changes in working capital <sup>(2)</sup> .....	680	(2,191)
Changes in noncurrent assets and liabilities .....	259	332
Net cash provided by operating activities .....	<u>\$ 5,068</u>	<u>\$ 3,999</u>

- (1) Includes deferred compensation, depreciation, gains and losses, interest accretion, income tax expense (benefit), and provision for losses on accounts receivable. For the year ended December 31, 2012, the amount includes the \$33.7 million valuation allowance related to the Company's net deferred income taxes.
- (2) Changes in working capital include changes to accounts receivable and accrued revenue, other current assets, accounts payable, accrued expenses and other current liabilities.

For the year ended December 31, 2012, GWRI's net cash provided by operating activities increased \$1.1 million, or 26.7%, to \$5.1 million compared to \$4.0 million in the year ended December 31, 2011. The increase was primarily driven by the higher rates we are able to charge our wastewater customers effective January 1, 2012, and the growth of our recurring FATHOM<sup>TM</sup> revenue stream, partially offset by a decrease in FATHOM<sup>TM</sup> implementation revenue during the 2012 compared to 2011.

**Cash Flows Used in Investing Activities** – Cash flows used in investing activities for the years ended December 31, 2012 and 2011 were as follows (in thousands of US\$):

	<b>Years Ended December 31,</b>	
	<b>2012</b>	<b>2011</b>
Capital expenditures – Growth .....	\$ (4,348)	\$ (6,710)
Capital expenditures – Maintenance .....	(826)	(628)
Other investing activities, net <sup>(1)</sup> .....	(2,645)	(20)
Net cash used in investing activities .....	<u>\$ (7,819)</u>	<u>\$ (7,358)</u>

- (1) Includes proceeds from the disposal of assets, and deposits and withdrawals of restricted cash.

For the year ended December 31, 2012, GWRI's net cash used in investing activities increased \$0.5 million, or 6.3%, compared to the year ended December 31, 2011. The increase was primarily attributable to \$2.6 million of additional funds paid into the bond service fund in connection with the June 2012 debt financings. This increase was partially offset by \$2.2 million lower capital expenditure during the year ended December 31, 2012.

GWRI intends to invest capital strategically in service areas where GWRI is able to deploy its TWM model, increase its service connection base and grow FATHOM<sup>TM</sup>. This may include strategic acquisitions and the construction of new water and wastewater treatment and delivery facilities. GWRI's projected capital expenditures and other investments are subject to periodic review and revision to reflect changes in economic conditions and other factors.

See Note 1 to GWRI's consolidated financial statements for the year ended December 31, 2012 for disclosure of a change in investing and financing activities for the interim periods of and the year ended December 31, 2012 to correct for the presentation of cash used for acquisitions of certain utilities.

**Cash Flows from Financing Activities** – GWRI's financing activities during the year ended December 31, 2012 include receipt of \$7.0 million of proceeds from a new term loan through Regions Bank and receipt of \$8.9 million of proceeds from a new promissory note with a related party which was used to pay off the WMC acquisition liability in the first quarter of 2012. During the second quarter of 2012, we refinanced the above debt at more favorable terms by issuing \$25.0 million of new debt consisting of \$7,625,000 of tax-exempt revenue bonds and \$6,375,000 of taxable revenue bonds through The Industrial Development Authority of the County of Pima, and an \$11,000,000 term loan through Regions Bank. With the proceeds from these financings we retired the \$7.0 million term loan with Regions Bank and the balance of the related party promissory note with a related party. Additionally, approximately \$4.0 million of the proceeds was used to repay the loans from the Water Infrastructure Finance Authority of Arizona in August 2012. Debt issuance costs paid in connection with the 2012 financings totaled approximately \$1.5 million.

Offsetting the effect of debt proceeds, financing activities included cash outflows of \$11.2 million and \$4.4 million during the years ended December 31, 2012 and 2011, respectively, related to scheduled payments for the WMC acquisition.

See Note 1 to GWRI's consolidated financial statements for the year ended December 31, 2012 for disclosure of a change in investing and financing activities for the interim periods of and the year ended December 31, 2012 to correct for the presentation of cash used for acquisitions of certain utilities.

See Note 7 to GWRI's consolidated financial statements for the year ended December 31, 2012 for additional information on outstanding debt instruments.

### **Regulatory Restrictions**

The issuance of long-term debt securities by GWRI does not require authorization of the ACC if no guarantee by or pledge of the assets of the regulated subsidiaries of GWRI is utilized. However, ACC authorization is required for the issuance of long-term debt by GWRI's regulated subsidiaries. GWRI's regulated subsidiaries normally obtain the required approvals on a periodic basis to cover their anticipated financing needs for a period of time or in connection with specific financing.

Under applicable law, GWRI can remit distributions when a surplus in equity exists and can pay dividends from retained, undistributed or current earnings. A significant loss recorded within GWRI or at a subsidiary may limit the payment of distributions and dividends.

### **Insurance Coverage**

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

## Contractual Obligations and Commitments

GWRI enters into obligations with third parties in the ordinary course of business. The amounts of these obligations, as of December 31, 2012 are set forth in the table below (in thousands of US\$):

<b>Contractual obligations <sup>(1)</sup></b>	<b>Total</b>	<b>Less than 1 Year</b>	<b>1 – 3 Years</b>	<b>4 – 5 Years</b>	<b>More than 5 Years</b>
Long term debt obligations <sup>(2)</sup>	\$ 136,037	\$ 3,080	\$ 8,562	\$ 9,780	\$ 114,615
Interest on long term debt <sup>(3)</sup>	130,923	8,097	15,724	14,918	92,184
Capital lease obligation	336	123	213	-	-
Interest on capital lease	31	19	12	-	-
Operating lease obligation	1,876	588	1,190	98	-
<b>Total</b>	<b>\$ 269,203</b>	<b>\$ 11,907</b>	<b>\$ 25,701</b>	<b>\$ 24,796</b>	<b>\$ 206,799</b>

- (1) In addition to these obligations, GWRI pays annual refunds on AIAC over a specific period of time based on operating revenues generated from developer-installed infrastructure. The refund amounts are considered an investment in infrastructure and eligible for inclusion in future rate base. These refund amounts are not included in the above table because the refund amounts and timing are dependent upon several variables, including new customer connections, customer consumption levels and future rate increases, which cannot be accurately estimated. Portions of these refund amounts are payable annually over the next two decades, and amounts not paid by the contract expiration dates become non-refundable and are transferred to CIAC.
- (2) The long-term debt obligations reflected in the table above exclude the debt discount related to the Series 2007 bonds. The debt discount at December 31, 2012 totaled \$400,000 and is netted within the bonds payable balance on GWRI's balance sheet. The debt discount is being amortized over the term of the Series 2007 bonds.
- (3) Interest on GWRI's Series 2006, 2007 and 2008 bonds is based on the fixed rates. Interest on GWRI's Series 2012 bonds and term loan is variable based on the LIBOR. We put in place a five year interest rate cap contract in September 2012 to reduce the risk of an increase in interest rates.

## Quantitative and Qualitative Disclosure about Market Risk

GWRI is exposed to market risk associated with changes in commodity prices, equity prices and interest rates. GWRI uses a combination of fixed-rate and variable-rate debt to reduce interest rate exposure. A hypothetical 10% increase in interest rates associated with variable rate debt would result in a \$53,000 increase in GWRI's pre-tax loss for the year ended December 31, 2012. To reduce the risk from interest rate fluctuations, we have entered into two five-year interest rate cap transaction agreements for our variable-rate bond debt. Under the interest rate cap agreements, the Company will be reimbursed for the interest costs that may occur in excess of the interest rate cap levels.

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

## Risk Factors

The Company's future performance and financial condition involves a number of risks and uncertainties. Any of these risks and uncertainties could have a material adverse effect on its results of operations, business prospects and financial condition. These risks are discussed in GWRC's most recent Annual Information Form, which is available on GWRC's SEDAR profile at [www.sedar.com](http://www.sedar.com).



## **Related Party Transactions**

See Note 6 to GWRI's consolidated financial statements for the year ended December 31, 2012.

## **Critical Accounting Policies and Estimates**

The application of critical accounting policies is particularly important to GWRI's financial condition and results of operations and provides a framework for management to make significant estimates, assumptions and other judgments. Additionally, GWRI's financial condition, results of operations and cash flow are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. Although GWRI's management believes that these estimates, assumptions and other judgments are appropriate, they relate to matters that are inherently uncertain and that may change in subsequent periods. Accordingly, changes in the estimates, assumptions and other judgments applied to these accounting policies could have a significant impact on GWRI's financial condition and results of operations as reflected in GWRI's financial statements. For further discussion of the Company's accounting policies and estimates, refer to GWRI's 2012 audited consolidated financial statements.

## **Disclosure Controls and Procedures and Internal Control over Financial Reporting**

### *Evaluation of Disclosure Controls and Procedures*

Our Chief Executive Officer and Chief Financial Officer reviewed and evaluated our disclosure controls and procedures. Based on that evaluation, they have concluded that our disclosure controls and procedures are effective in providing them with timely material information relating to the Company.

### *Management's Annual Report on Internal Control Over Financial Reporting*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, and has designed such internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of financial statements for external purposes in accordance with U.S. GAAP.

Management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our internal controls and procedures over financial reporting will prevent all error and all fraud. A control system can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving our stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has evaluated the design and operation of our internal control over financial reporting as of December 31, 2012, and has concluded that such internal control over financial reporting is effective as of December 31, 2012. There are no material weaknesses that have been identified by management in this regard. This assessment was

based on criteria for effective internal control over financial reporting described in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

*Changes in Internal Controls over Financial Reporting*

There were no changes in our internal control over financial reporting that occurred during the last fiscal year that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Other Required Disclosures**

Additional information relating to GWRI, including GWRC's Annual Information Form, has been filed on GWRC's profile on SEDAR at [www.sedar.com](http://www.sedar.com).

\* \* \* \* \*



March 28, 2013

To Our Shareholders:

GWR Global Water Resources Corp. (“**GWRC**”) is pleased to present our financial statements, along with the financial statements of Global Water Resources, Inc. (“**GWRI**”), for the year ended December 31, 2012. Because GWRI represents the sole asset of GWRC and is not consolidated into the financial statements of GWRC, the financial statements of GWRI for the year ended December 31, 2012 are filed together with the financial statements of GWRC.

On behalf of the Board of Directors, President and Chief Executive Officer, management and employees of GWRC and GWRI, I thank you for your ongoing support.

Warm Regards,

Cindy M. Liles  
Executive Vice President and Chief Financial Officer

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# **GWR GLOBAL WATER RESOURCES CORP.**

FINANCIAL STATEMENTS AS OF AND FOR THE YEARS  
ENDED DECEMBER 31, 2012 AND 2011

## **INDEPENDENT AUDITORS' REPORT**

To the Board of Directors and Shareholders of  
GWR Global Water Resources Corp.  
Vancouver, British Columbia, Canada

We have audited the accompanying financial statements of GWR Global Water Resources Corp. (the "Company"), which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of operations, shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America (and Canada). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of GWR Global Water Resources Corp. as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Deloitte & Touche LLP*

March 28, 2013

**GWR GLOBAL WATER RESOURCES CORP.**  
**BALANCE SHEETS**  
**As of December 31, 2012 and 2011**

	<u>Notes</u>	<u>December 31, 2012</u>	<u>December 31, 2011</u>
		(in thousands of US\$, except share data)	
<b>ASSETS</b>			
CURRENT ASSETS:			
Cash and cash equivalents .....		\$ -	\$ -
Other current assets .....		1	-
Total current assets .....		<u>1</u>	<u>-</u>
Equity method investment .....	3	34,852	54,063
TOTAL ASSETS .....		<u><u>\$ 34,853</u></u>	<u><u>\$ 54,063</u></u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
LIABILITIES:			
Accounts payable and accrued expenses .....		\$ 32	\$ 8
Due to related party .....		-	256
Other noncurrent liabilities .....		41	25
Total liabilities .....		<u>73</u>	<u>289</u>
COMMITMENTS AND CONTINGENCIES (see Note 8)			
SHAREDHOLDERS' EQUITY:			
Common stock, unlimited shares authorized, 8,754,612 shares issued and outstanding at December 31, 2012 and 2011 .....	6	55,767	55,670
Accumulated deficit .....		(20,987)	(1,896)
Total shareholders' equity .....		<u>34,780</u>	<u>53,774</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY ..		<u><u>\$ 34,853</u></u>	<u><u>\$ 54,063</u></u>

See accompanying notes to the consolidated financial statements.



**GWR GLOBAL WATER RESOURCES CORP.**  
**STATEMENTS OF OPERATIONS**  
**For the Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
	(in thousands of US\$, except share and per share data)	
LOSS FROM EQUITY INVESTMENT .....	\$ (18,694)	\$ (1,580)
OPERATING EXPENSES .....	397	255
OPERATING LOSS.....	<u>(19,091)</u>	<u>(1,835)</u>
LOSS BEFORE INCOME TAXES.....	(19,091)	(1,835)
INCOME TAX BENEFIT .....	-	-
NET LOSS.....	<u><u>\$ (19,091)</u></u>	<u><u>\$ (1,835)</u></u>
WEIGHTED AVERAGE SHARES:		
Basic .....	8,754,612	8,712,476
Diluted .....	8,754,612	8,712,476
LOSS PER SHARE:		
Basic .....	\$ (2.18)	\$ (0.21)
Diluted .....	\$ (2.18)	\$ (0.21)

See accompanying notes to the consolidated financial statements.

**GWR GLOBAL WATER RESOURCES CORP.**  
**STATEMENTS OF SHAREHOLDERS' EQUITY**  
**For the Years Ended December 31, 2012 and 2011**

	<u>Shares</u>	<u>Common Stock</u>	<u>Accumulated Deficit</u>	<u>Total Equity</u>
	(in thousands of US\$, except share amounts)			
BALANCE – December 31, 2010 .....	8,185,001	\$ 51,659	\$ (61)	\$ 51,598
Receipt of gross proceeds from stock issuance .....	569,611	4,273	-	4,273
Issuance costs – underwriters' commissions .....	-	(256)	-	(256)
Issuance costs – legal, professional and other costs .....	-	(6)	-	(6)
Net loss .....	-	-	(1,835)	(1,835)
	<hr/>	<hr/>	<hr/>	<hr/>
BALANCE – December 31, 2011 .....	8,754,612	\$ 55,670	\$ (1,896)	\$ 53,774
Stock-based compensation .....	-	97	-	97
Net loss .....	-	-	(19,091)	(19,091)
	<hr/>	<hr/>	<hr/>	<hr/>
BALANCE – December 31, 2012 .....	8,754,612	\$ 55,767	\$ (20,987)	\$ 34,780
	<hr/>	<hr/>	<hr/>	<hr/>

See accompanying notes to the consolidated financial statements.

**GWR GLOBAL WATER RESOURCES CORP.**  
**STATEMENTS OF CASH FLOWS**  
**For the Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
	(in thousands of US\$)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss.....	\$ (19,091)	\$ (1,835)
Adjustments to reconcile net loss to net cash used in operating activities:		
Deferred compensation .....	51	-
Loss from equity investment .....	18,694	1,580
Changes in assets and liabilities .....	(217)	255
Net cash used in operating activities.....	<u>(563)</u>	<u>-</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from the sale of stock .....	-	4,273
Issuance costs paid.....	-	(262)
Net cash provided by financing activities .....	<u>-</u>	<u>4,011</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of equity investment.....	-	(4,011)
Deemed distribution from related party.....	563	-
Net cash provided by (used in) investing activities.....	<u>563</u>	<u>(4,011)</u>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	-	-
<b>CASH AND CASH EQUIVALENTS – Beginning of year.....</b>	-	-
<b>CASH AND CASH EQUIVALENTS – End of year .....</b>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>
<b>Supplementary disclosure:</b>		
Income taxes paid .....	\$ -	\$ -
Interest paid .....	\$ -	\$ -

See accompanying notes to the consolidated financial statements.

**GWR GLOBAL WATER RESOURCES CORP.**  
**Notes to the Financial Statements**

**1. GENERAL BUSINESS DESCRIPTION**

GWR Global Water Resources Corp. (the “Company”, “GWRC”, “we”, or “us”) was incorporated under the *Business Corporations Act* (British Columbia) on March 23, 2010 to acquire shares of Global Water Resources, Inc. (“GWRI”), a corporation incorporated in the State of Delaware of the United States of America, and to actively participate in the management, business and operations of GWRI through its representation on the board of GWRI and its shared management with GWRI. The formation of GWRI occurred through a reorganization of Global Water Resources, LLC and its subsidiaries and Global Water Management, LLC (the predecessors of GWRI).

GWRI operates in the Western United States as a water resource management company that owns and operates regulated water, wastewater and recycled water utilities in strategically located communities, principally in metropolitan Phoenix, Arizona. GWRI’s model focuses on the broad issues of water supply and scarcity and applies principles of water conservation through water reclamation and reuse. The basic premise of GWRI’s business is that the world’s water supply is limited and yet can be stretched significantly through effective planning, the use of recycled water and by providing individuals and communities resources that promote wise water usage practices. GWRI deploys its integrated approach, Total Water Management (“TWM”), a term which it uses to mean managing the entire water cycle, both to conserve water and to maximize its total economic and social value. GWRI uses TWM to promote sustainable communities in areas where GWRI expects growth to outpace the existing potable water supply.

Leveraging its investment in technology that was initially developed to support and optimize its own utilities, GWRI also has an unregulated business, whose services are now marketed by GWRI as FATHOM Utility-to-Utility (“U<sub>2</sub>U™”) Solutions (“FATHOM™”). FATHOM™ offers an integrated suite of advanced technology-enabled platforms to provide attractive third party services to municipalities and private utilities. The services offered by FATHOM™ provide automation, cost savings and opportunities for increased revenues.

The Company, pursuant to an underwriting agreement with a syndicate of underwriters dated December 16, 2010, filed a prospectus (the “Offering Prospectus”) on December 16, 2010 for an initial public offering (the “Offering”) of 8,185,000 common shares of the Company at C\$7.50 per share. On December 30, 2010, the Company completed the Offering and raised gross proceeds totaling C\$61,387,500. On January 28, 2011, the underwriters of the Offering exercised their over-allotment option for an additional 569,611 common shares at C\$7.50 per share resulting in additional gross proceeds of C\$4,272,083. Net proceeds from the Offering, including from the exercise of the over-allotment option, were used to purchase 87,546 shares of GWRI’s common stock, representing a total ownership interest in GWRI of approximately 48.1% (see Note 3).

**Basis of Presentation** – The financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). Amounts are stated in U.S. dollars unless otherwise noted.

Subsequent events have been evaluated through March 21, 2013, the date on which the financial statements were approved by the board of directors.

**Conversion to U.S. GAAP** – In February 2008, the Accounting Standards Board (AcSB) of the Canadian Institute of Chartered Accountants (CICA) confirmed that publicly accountable enterprises would be required to convert to International Financial Reporting Standards (IFRS) in place of Canadian generally accepted

**GWR GLOBAL WATER RESOURCES CORP.**  
**Notes to the Financial Statements (Continued)**

accounting principles for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011.

In September 2010, the AcSB decided to offer an optional one year deferral for conversion to IFRS for qualifying entities with rate regulated activities and permit such entities to continue to apply Part V – Pre-changeover accounting standards of the CICA Handbook during that period. The Company is a qualifying entity for purposes of this deferral which we elected.

Further, during 2011, we applied for, and in July 2011 received, an exemption from the Ontario Securities Commission allowing the Company and GWRI to adopt U.S. GAAP and defer the conversion to IFRS until financial years beginning on or after January 1, 2015. Accordingly, effective January 1, 2012, we converted to U.S. GAAP.

For all periods up to and including the year ended December 31, 2011, we prepared our annual and interim financial statements in accordance with Part V – Pre-changeover accounting standards of the CICA Handbook.

As indicated above, we have prepared our financial statements to comply with U.S. GAAP applicable for periods on or after January 1, 2012. The conversion to U.S. GAAP has been made on a retrospective basis. While the financial statements for prior periods presented herein have been restated in accordance with U.S. GAAP in effect at the date of transition to U.S. GAAP effective January 1, 2012, there was no impact of such restatement on our statement of operations for the year ended December 31, 2011, balance sheet as of December 31, 2011 or the statement of cash flows for the year ended December 31, 2011. As such, no reconciliation of the transition to U.S. GAAP is presented.

**Use of accounting estimates** – U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses as well as disclosures of contingent assets and liabilities in the financial statements. We use estimates for certain items such as income taxes, fair values of financial instruments and commitments and contingencies. By nature, these estimates and assumptions are subject to measurement uncertainty and as such, actual results could differ from estimates used in these financial statements.

**Economic dependence** – We are economically dependent on GWRI. Our ability to pay distributions is entirely dependent on the distributions received from GWRI. Significant events affecting or transactions involving GWRI could materially influence our ability to pay distributions. We also rely on GWRI for payment of our operating expenses (see Note 4).

**Recently adopted accounting standard** – Presentation of Comprehensive Income: In June 2011, the Financial Accounting Standards Board (FASB) issued guidance on the presentation of comprehensive income. This guidance eliminates the option of presenting components of other comprehensive income as part of the statement of changes in stockholders' equity. The guidance gives entities the option to present the total of comprehensive income, the components of net income and the components of other comprehensive income in either a single continuous statement of comprehensive income or in two separate but consecutive statements.

In December 2011, the FASB issued an amendment to indefinitely defer one of the requirements contained in its June 2011 final standard. That requirement called for reclassification adjustments from accumulated other comprehensive income to be measured and presented by income statement line item in net income and also in other comprehensive income. This guidance, including the related deferral, is effective for fiscal years and

**GWR GLOBAL WATER RESOURCES CORP.**  
**Notes to the Financial Statements (Continued)**

interim periods beginning after December 15, 2011 and must be applied retrospectively. We adopted this guidance on January 1, 2012; however, this guidance will only impact our financial statements if we have components of comprehensive income besides net income in the future. Therefore, no statement of comprehensive income has been included.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Equity method investments** – We account for our investment in GWRI using the equity method of accounting because we exercise significant influence over GWRI's operating, investing and financial policies but such rights do not result in a controlling financial interest. Under the equity method of accounting, an investment is initially recorded at cost. Any excess of the cost of the acquisition over our share of the net fair value of identifiable assets and liabilities of an equity accounted investee at the date of the acquisition is recognized as goodwill, which is included within the carrying amount of the investment.

When there is a loss in value of an equity accounted investment that is other than temporary, the carrying amount of the investment is written down to reflect the loss. The amount of the write down is recorded in net income and is not reversed even if there is a subsequent increase in value (see Note 3).

The carrying value is adjusted thereafter to include the investor's pro rata share of post-acquisition earnings of the investee. The amount of the adjustment is included in the determination of net income by the investor, and the investment account of the investor is also increased or decreased to reflect the investor's share of capital transactions and changes in accounting policies and corrections of errors relating to prior period financial statements applicable to post-acquisition periods. Profit distributions received or receivable from an investee reduce the carrying value of the investment.

Income or losses from equity investment is recorded based on our percentage ownership in the net earnings of investments over which we exercise significant influence over operating, investing and financial policies but over which we do not have control.

**Distributions** – Distributions receivable are recorded when declared. Distributions payable to our shareholders are recorded when declared.

**Income taxes** – We utilize the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized.

We evaluate uncertain tax positions using a two-step approach. Recognition (step one) occurs when we conclude that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) determines the amount of benefit that more-likely-than-not will be realized upon settlement. Derecognition of a tax position that was previously recognized would occur when we subsequently determine that a tax position no longer meets the more-likely-than-not threshold of being sustained.

**GWR GLOBAL WATER RESOURCES CORP.**  
**Notes to the Financial Statements (Continued)**

The Company is incorporated in Canada and, as such, is subject to income tax provisions in Canada. Furthermore, the Company was formed to acquire shares in a U.S. corporation, GWRI. The U.S. Internal Revenue Code has provisions dealing with the “inversion” of a U.S. corporation, which provide that a non-U.S. corporation may be treated as a U.S. corporation for U.S. federal income tax purposes in certain circumstances. Management believes that the Company should not be treated as a U.S. corporation for U.S. federal income tax purposes pursuant to the inversion rules because the Company has not acquired and should not be deemed to have acquired substantially all of the stock or assets of GWRI, as provided for under current U.S. income tax guidelines, which is generally more than fifty percent. Additionally, any investment in the Company by historical shareholders of GWRI will bear no relationship to their respective historical ownership of GWRI and will be on the same terms made available to the public.

However, there is a risk that the U.S. Internal Revenue Service could take a contrary position and assert that the Company should be treated as a U.S. corporation under the inversion rules as a result of the transactions which took place under the investment agreement between the Company and GWRI dated December 30, 2010 under which the Company acquired its interest in GWRI (the “Investment Agreement”). As a result, if the Company were subsequently determined to be a U.S. corporation for U.S. federal income tax purposes under the inversion rules, the Company could owe U.S. corporate income tax, withholding tax, penalties and interest, which could be significant. Such treatment may be retroactive to the Company’s initial acquisition of shares of GWRI if a subsequent acquisition is considered to be part of a plan or series of related transactions that includes the transactions contemplated under the Investment Agreement.

**Earnings per share** – Basic earnings per share is based on the weighted average number of shares outstanding during the period. Diluted earnings per share is computed in accordance with the treasury stock method and based on the weighted average number of shares and dilutive share equivalents.

### **3. ACQUISITION OF INVESTMENTS**

From its inception through the date of the Offering, the Company did not make any investments.

The Company completed its initial public offering on December 30, 2010, with gross Offering proceeds totaling C\$61,387,500. On December 30, 2010, the Company used the net proceeds of the Offering in the amount of \$55,363,000 for (i) the payment of approximately \$51,659,000 for 81,850 shares of GWRI common stock (an approximate 46.4% interest in GWRI), and (ii) reimbursement of approximately \$3,704,000 of Offering expenses incurred by GWRI on our behalf (see Note 6).

During 2010, all legal, professional and other costs incurred in connection with the Offering had been capitalized as deferred financing costs on GWRI’s balance sheet. All such amounts were charged to the Company upon consummation of the Offering on December 30, 2010 and are netted against equity in our balance sheet.

On January 28, 2011, the underwriters of the Offering exercised their over-allotment option and with the related net proceeds of \$4,011,000, we purchased an additional 5,696 shares of GWRI’s common stock, resulting in the Company owning an approximate 48.1% of GWRI (see Note 6).



**GWR GLOBAL WATER RESOURCES CORP.**  
**Notes to the Financial Statements (Continued)**

The Company completed the process of determining the allocation of the amount invested in GWRI common stock to the underlying fair value of the net assets of GWRI. The allocation of the amount invested in GWRI is set forth as follows (in thousands of US\$):

Net assets of GWRI .....	\$ (19,976)
Intangible asset - FATHOM™ contracts.....	1,242
Goodwill .....	74,733
Deferred tax liability.....	(329)
Total.....	<u>\$ 55,670</u>

The components of the allocation are aggregated in the carrying value of the equity method investment in the Company's balance sheet. The portion of the allocation attributed to the intangible asset will be amortized over the contractual lives of the underlying FATHOM™ contracts. As indicated above, a deferred tax liability was established as a result of the book versus tax basis difference created by the intangible asset. Amortization of the intangible asset and the reversal of the deferred tax liability will be recorded each period as a component of the Company's income (loss) from equity investment. Approximately \$137,000 of the intangible asset was amortized and approximately \$36,000 of the deferred tax liability was reversed during 2012.

Our interest in GWRI shares provides certain rights with respect to GWRI, including the right to appoint three of the six directors of GWRI's board of directors (the "Board"). However, the owners of the remaining shares of GWRI have the right to increase the size of the Board to seven members and appoint the seventh member as long as their interest in GWRI exceeds 50%, upon written notice to the Board.

The Company's loss on its equity investment totaled approximately \$18,694,000 and \$1,580,000 for the years ended December 31, 2012 and 2011, respectively. To date, no distributions have been declared or received from investments. The increased loss on equity investment for the year ended December 31, 2012 was primarily a result of a valuation allowance recorded against GWRI's net deferred tax assets during the second quarter of 2012.

**GWR GLOBAL WATER RESOURCES CORP.**  
**Notes to the Financial Statements (Continued)**

The following contains summarized financial data of GWRI's financial position as of December 31, 2012 and 2011 (in thousands of US\$):

	<u>December 31, 2012</u>	<u>December 31, 2011</u>
<b>ASSETS:</b>		
Net property, plant and equipment .....	\$ 260,236	\$ 265,948
Current assets .....	8,750	9,138
Other assets .....	30,411	55,536
<b>TOTAL ASSETS.....</b>	<b><u>\$ 299,397</u></b>	<b><u>\$ 330,622</u></b>
<b>LIABILITIES:</b>		
Current liabilities .....	\$ 14,707	\$ 21,570
Noncurrent liabilities .....	311,254	296,690
<b>TOTAL LIABILITIES.....</b>	<b><u>325,961</u></b>	<b><u>318,260</u></b>
<b>SHAREHOLDERS' EQUITY (DEFICIT).....</b>	<b><u>(26,564)</u></b>	<b><u>12,362</u></b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT).....</b>	<b><u>\$ 299,397</u></b>	<b><u>\$ 330,622</u></b>

The following contains summarized financial data of GWRI's results of operations for the years ended December 31, 2012 and 2011 (in thousands of US\$):

	<u>Years Ended December 31,</u>	
	<u>2012</u>	<u>2011</u>
Revenues .....	\$ 33,538	\$ 36,405
Operating expenses .....	32,550	32,836
Operating income (loss) .....	988	3,569
Total other expense, net .....	(8,802)	(8,849)
Loss before income taxes .....	(7,814)	(5,280)
Income tax (expense) benefit.....	(30,667)	1,972
<b>Net loss .....</b>	<b><u>\$ (38,481)</u></b>	<b><u>\$ (3,308)</u></b>

We evaluate our investment in GWRI 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. We concluded that an impairment of the investment did exist as of December 31, 2011; however based on our evaluation of various relevant factors, including the ability of GWRI to achieve and sustain an earnings capacity that would justify the carrying amount of our investment and consideration of our intent and ability to retain our investment for a sufficient period of time to allow for recovery of the indicated impairment, the conclusion was made that the indicated impairment was temporary. Through December 31, 2012, GWRI's results of operations were below GWRI's previous forecasts. This combined with the continued decline in the trading price of our stock warranted a review of the carrying value of our investment in GWRI for impairment. We have updated our valuation assessment and have concluded that an impairment of the investment as of December 31, 2012 did not exist. However, this analysis is sensitive to management assumptions including forecasted results of GWRI and, as a result, changes in these assumptions could have a material impact on the analysis.

**GWR GLOBAL WATER RESOURCES CORP.**  
**Notes to the Financial Statements (Continued)**

**4. RELATED PARTY TRANSACTIONS**

Except for the Chief Executive Officer and Chief Financial Officer (who serve the same roles at GWRI and receive no compensation from the Company in connection with their roles), we have no employees and the management and general administration services of our business and affairs are provided by GWRI pursuant to a management agreement. The services provided by GWRI pursuant to the management agreement include, but are not limited to the following:

- monitoring compliance by the Company at all times with the constraints on the ownership of common shares of the Company by U.S. Persons as imposed by the United States Investment Company Act of 1940;
- managing the timely preparation of the annual and interim financial statements of the Company, as well as relevant tax information and providing or causing the same to be provided to the Company's shareholders, as appropriate;
- managing the audit of the annual financial statements of the Company by the Company's auditors;
- managing the preparation of all of the Company's income, sales or commodity tax returns and filings and arranging for their filing within the time required by applicable tax law;
- rendering such services as requested by the Company's officers or the board to implement the advice of the professionals engaged by the Company for advice regarding compliance by the Company with all applicable laws and stock exchange requirements including, without limitation, all continuous disclosure obligations under securities laws;
- managing the preparation of any circular or other disclosure document required under applicable securities laws in response to an offer to purchase securities of the Company;
- providing investor relations services for the Company;
- managing the logistics of calling and holding all annual and/or special meetings of shareholders and preparing, and arranging for the distribution of all materials (including notices of meetings and information circulars) in respect thereof;
- with the advice of the Company's advisors, preparing and providing or causing to be provided to shareholders on a timely basis all information to which shareholders are entitled under applicable laws and stock exchange requirements, including financial statements relating to the Company and GWRI;
- managing the timing and terms of future offerings of securities of the Company, if any, as requested by the board or officers of the Company;
- obtaining and maintaining the insurance coverage selected by the board or officers for the benefit of the Company and its directors and officers;
- providing such services as requested by the board or officers of the Company in regard to any financings by the Company;
- assisting in the preparation and coordination of meetings of the board, including preparation of minutes of meetings of the board;
- preparing, and delivering, on behalf of the Company and with the advice of the Company's advisors, any prospectus or comparable document of the Company to qualify the sale or distribution of securities of the Company from time to time;
- promptly notifying the Company of any information or event that, to GWRI's knowledge, might reasonably be expected to have a material adverse effect with respect to the Company or that might reasonably be expected to be a "material change" or "material fact" as regards the Company or GWRI; and
- providing all other services as may be requested by the Company, for the administration of the business and affairs of the Company.

**GWR GLOBAL WATER RESOURCES CORP.**  
**Notes to the Financial Statements (Continued)**

Services provided by GWRI are provided at no charge to the Company.

Notwithstanding the foregoing, the Company is solely responsible for the selection of accountants, lawyers, consultants, investment bankers and other such professional advisors, as well as other service providers from time to time, to provide advice and other administrative services directly to the Company. Further, the Company is responsible for certain costs including the fees paid to members of our board of directors. Since the Company has no cash and does not expect to have cash flows from operating activities, the operating costs incurred by the Company are paid by GWRI. Amounts paid by GWRI on the Company's behalf through December 31, 2012 totaled \$563,000. The Company previously reported the amount paid by GWRI on its behalf as a liability due to the related party. However, since the Company is not able to objectively determine when the related party liability will be settled, the liability has been reclassified to equity method investment as of December 31, 2012.

The management agreement may be terminated (i) by the Company, in its sole discretion, by notice in writing to GWRI at least 30 days prior to the effective date of termination; (ii) by either party in the event of the termination of the existence of the Company or the insolvency, receivership or bankruptcy of GWRI, or in the case of default by the other party in the performance of a material obligation under the management agreement which is not remedied within 30 days after notice thereof has been delivered to the defaulting party; and (iii) if the Company no longer holds voting securities of GWRI.

A copy of the management agreement is available on the Company's SEDAR profile at [www.sedar.com](http://www.sedar.com).

*Stock option grant to employees of GWRI* – In January 2012, the Company's Board of Directors granted 385,697 options to acquire GWRC common stock to nine employees of GWRI pursuant to the GWR Global Water Resources Corp. Stock Option Plan (the "Option Plan"). The options vest in equal installments over the eight quarters of 2012 and 2013 and expire four years after the date of issuance. We account for the option grant in accordance with FASB's Accounting Standards Codification (ASC) 323, *Investment-Equity Method & Joint Ventures*. At December 31, 2012, the estimated fair value of the unvested options was \$33,000 based on a Black-Scholes pricing model. The options were initially measured on June 30, 2012, the first period-end following the date when the Option Plan received shareholder approval. The Company will remeasure the fair value of the award at the end of each period until the options are fully vested.

As part of loss from equity investment, 48.1% of the stock compensation cost recorded by GWRI as a result of the award under the Option Plan is included in the Company's statement of operations, reflecting the Company's equity method interest in GWRI's results of operations. Additionally, whereas the Company is providing the entire compensation award to GWRI despite the Company's 48.1% interest, the Company recorded compensation expense within operating expenses related to the stock option award totaling \$51,000 for the year ended December 31, 2012, representing the remaining 51.9% of the total compensation for such awards. This 51.9% amount represents the amount that the Company's claim on GWRI's book value has not been increased which benefits the noncontributing investors.

## **5. INCOME TAXES**

The Company purchased an equity investment in GWRI on December 30, 2010. Income or loss generated by GWRI will result in outside basis differences between the carrying value of the investment compared to the tax basis of the investment. Outside basis differences between the carrying value and the tax basis of the investment in GWRI were evaluated for the tax consequences of the potential realization of an equity

**GWR GLOBAL WATER RESOURCES CORP.**  
**Notes to the Financial Statements (Continued)**

investment (e.g., disposition, dividends, return of capital, etc.) to determine the proper accounting for the reversal of any temporary differences in the tax basis and carrying value of the investment. At December 31, 2011, the book versus tax basis difference in the Company's equity investment totaled approximately \$1.6 million and a corresponding deferred tax asset has been recorded in the amount of \$426,000 based on a combined statutory tax rate of 26.5%. At December 31, 2012, the book versus tax basis difference in the Company's equity investment totaled approximately \$20.8 million and a deferred tax asset has been recorded in the amount of \$5.5 million based on a combined statutory tax rate of 26.5%. However, as it is not more-likely-than-not that the deferred tax asset will be realized in the foreseeable future, a full valuation allowance has been recorded against the deferred tax asset for all periods.

**6. SHAREHOLDERS' EQUITY**

The Company has a single class of common shares authorized for issuance and each share entitles the holder thereof to one vote per share.

Prior to the Offering, no capital had been contributed into the Company and no shares of the Company had been issued, with the exception of a single common share in connection with the initial organization of the Company.

As discussed in Note 1, on December 30, 2010, the Company completed its Offering of 8,185,000 common shares at C\$7.50 per share for gross proceeds totaling C\$61,387,500, or approximately US\$61,189,000. The costs incurred in connection with the Offering have been netted against equity in our balance sheet as of December 31, 2010. Net proceeds from the Offering, after taking into consideration underwriters' commissions of approximately \$3,671,000 and legal, professional and other Offering costs of approximately \$5,859,000, totaled approximately \$51,659,000.

On January 28, 2011, the underwriters of the Offering exercised their over-allotment option for an additional 569,611 common shares at C\$7.50 per share. Net proceeds from the exercise of the over-allotment option, after taking into account underwriters' commissions and issuance costs of \$262,000, were \$4,011,000. Such net proceeds were used to purchase 5,696 shares of GWRI's common stock on January 28, 2011, increasing the Company's ownership interest in GWRI to approximately 48.1%.

**GWR GLOBAL WATER RESOURCES CORP.**  
**Notes to the Financial Statements (Continued)**

**7. CAPITAL MANAGEMENT AND LIQUIDITY MATTERS**

As discussed in Note 1, we are economically dependent on GWRI. Our ability to service operating costs and pay distributions (if any) is entirely dependent on the receipt of distributions, or loans, from GWRI. Significant events affecting or transactions involving GWRI could materially influence our ability to make such payments.

We do not carry on any active business operations as our activities are generally restricted to holding securities of our equity investee, GWRI. To date, we have not incurred debt to finance our investments. Therefore, our capital structure is composed solely of our shareholders' equity.

**8. COMMITMENTS AND CONTINGENCIES**

**Commitments** – As discussed in Note 4, the Company uses the services of GWRI for the management and general administration of our business and affairs. The Company does not pay a fee for these services. We currently have no commitments expected to result in future minimum payments.

**Contingencies** – From time to time, we may become involved in proceedings arising in the ordinary course of business of which the ultimate resolution of such matters could materially affect our financial position, results of operations, or cash flows. Since inception, the Company has not identified any contingencies which we believe could materially affect our financial statements.

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# **GLOBAL WATER RESOURCES, INC.**

CONSOLIDATED FINANCIAL STATEMENTS AS OF AND  
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011



## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of  
Global Water Resources, Inc.  
Phoenix, Arizona

We have audited the accompanying consolidated financial statements of Global Water Resources, Inc. and its subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations, shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Global Water Resources, Inc. and its subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Deloitte & Touche LLP*

March 28, 2013

**GLOBAL WATER RESOURCES, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**As of December 31, 2012 and 2011**

	December 31, 2012	December 31, 2011
	(in thousands of US\$, except share data)	
<b>ASSETS</b>		
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
Property, plant and equipment.....	\$ 321,697	\$ 317,804
Less accumulated depreciation .....	(61,461)	(51,856)
Net property, plant and equipment.....	<u>260,236</u>	<u>265,948</u>
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents.....	3,816	2,233
Accounts receivable – net .....	1,926	2,779
Other receivables .....	215	444
Accrued revenue .....	1,599	1,254
Prepaid expenses and other current assets .....	1,194	425
Deferred tax asset – current .....	-	2,003
Total current assets .....	<u>8,750</u>	<u>9,138</u>
<b>OTHER ASSETS:</b>		
Goodwill.....	13,082	13,082
Intangible assets – net.....	1,545	1,545
Regulatory assets .....	715	486
Deposits .....	43	63
Bond service fund and other restricted cash .....	11,383	9,287
Debt issuance costs – net.....	3,643	3,005
Deferred tax assets.....	-	28,068
Total other assets.....	<u>30,411</u>	<u>55,536</u>
<b>TOTAL</b> .....	<u>\$ 299,397</u>	<u>\$ 330,622</u>
<b>LIABILITIES AND EQUITY (DEFICIT)</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable.....	\$ 3,676	\$ 3,637
Accrued expenses .....	4,263	3,884
Deferred revenue – current portion .....	1,000	2
Acquisition liability – current portion .....	-	5,919
Customer and meter deposits .....	2,565	2,371
Long-term debt – current portion .....	3,203	5,757
Total current liabilities.....	<u>14,707</u>	<u>21,570</u>
<b>NONCURRENT LIABILITIES:</b>		
Long-term debt.....	132,770	115,476
Advances in aid of construction.....	100,192	105,331
Contributions in aid of construction – net .....	71,879	64,775
Deferred income tax liability .....	589	-
Acquisition liability .....	4,688	10,395
Other noncurrent liabilities .....	1,136	713
Total noncurrent liabilities .....	<u>311,254</u>	<u>296,690</u>
Total liabilities .....	<u>325,961</u>	<u>318,260</u>
Commitments and contingencies (see Note 12)		
<b>EQUITY (DEFICIT):</b>		
Common stock, \$0.01 par value, 1,000,000 shares authorized, 182,050 shares issued and outstanding at December 31, 2012 and 2011 .....	2	2
Paid in capital .....	55,286	55,731
Accumulated deficit .....	(81,852)	(43,371)
Total equity (deficit) .....	<u>(26,564)</u>	<u>12,362</u>
<b>TOTAL</b> .....	<u>\$ 299,397</u>	<u>\$ 330,622</u>

See accompanying notes to the consolidated financial statements.

**GLOBAL WATER RESOURCES, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
	(in thousands of US\$)	
REVENUES:		
Water services.....	\$ 17,417	\$ 17,130
Wastewater and recycled water services.....	13,244	11,412
Unregulated revenues.....	2,877	7,863
Total revenues.....	<u>33,538</u>	<u>36,405</u>
OPERATING EXPENSES:		
Operations and maintenance.....	11,994	12,157
General and administrative .....	9,657	10,192
Depreciation.....	10,899	10,487
Total operating expenses.....	<u>32,550</u>	<u>32,836</u>
OPERATING INCOME.....	<u>988</u>	<u>3,569</u>
OTHER INCOME (EXPENSE):		
Interest income.....	6	2
Interest expense .....	(9,565)	(8,908)
Other.....	757	57
Total other income (expense).....	<u>(8,802)</u>	<u>(8,849)</u>
LOSS BEFORE INCOME TAXES.....	(7,814)	(5,280)
INCOME TAX (EXPENSE) BENEFIT .....	(30,667)	1,972
NET LOSS.....	<u>\$ (38,481)</u>	<u>\$ (3,308)</u>

See accompanying notes to the consolidated financial statements.

**GLOBAL WATER RESOURCES, INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT)**  
**For the Years Ended December 31, 2012 and 2011**

	Common Stock	Paid-in Capital	Accumulated Deficit	Total Equity (Deficit)
		(in thousands of US\$)		
BALANCE – December 31, 2010.....	\$ 2	\$ 51,679	\$ (40,063)	\$ 11,618
Stock-based compensation.....	-	41	-	41
Receipt of proceeds from stock issuance (5,696 shares issued).....	-	4,011	-	4,011
Net loss.....	-	-	(3,308)	(3,308)
BALANCE – December 31, 2011.....	\$ 2	\$ 55,731	\$ (43,371)	\$ 12,362
Stock-based compensation.....	-	118	-	118
Deemed distribution to related party.....	-	(563)	-	(563)
Net loss.....	-	-	(38,481)	(38,481)
BALANCE – December 31, 2012.....	\$ 2	\$ 55,286	\$ (81,852)	\$ (26,564)

See accompanying notes to the consolidated financial statements.

**GLOBAL WATER RESOURCES, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Years Ended December 31, 2012 and 2011**

	2012	2011
	(in thousands of US\$)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss.....	\$ (38,481)	\$ (3,308)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Deferred compensation.....	357	471
Depreciation.....	10,899	10,487
Amortization of deferred debt issuance costs and discounts.....	353	243
Write-off of debt issuance costs.....	618	-
Loss on disposal of fixed and intangible assets.....	19	45
Gain on advance in aid of construction purchase.....	-	(22)
Gain on settlement of acquisition liability.....	-	(80)
Imputed interest expense on deferred payments for acquisitions – net of cash paid.....	(463)	(191)
Provision for doubtful accounts receivable.....	160	185
Deferred income tax expense (benefit).....	30,667	(1,972)
Changes in assets and liabilities – excluding effects of acquisitions:		
Accounts receivable.....	658	(1,218)
Other current assets.....	(807)	(675)
Accounts payable and other current liabilities.....	829	(298)
Other noncurrent assets.....	(354)	(80)
Other noncurrent liabilities.....	613	412
Net cash provided by operating activities.....	5,068	3,999
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures.....	(5,174)	(7,338)
Proceeds from disposal of fixed and intangible assets.....	-	35
Deposits (withdrawals) of restricted cash.....	(2,645)	(62)
Deposits received.....	-	7
Net cash used in investing activities.....	(7,819)	(7,358)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from bonds.....	14,000	-
Repayments of bonds.....	(2,090)	(1,260)
Loan borrowings.....	18,000	16,510
Loan repayments.....	(15,526)	(21,903)
Principal payments under capital lease.....	(52)	-
Deposit into escrow for debt service.....	(3,923)	-
Redemption from escrow for debt service.....	3,923	-
Related-party loan proceeds.....	8,910	-
Related-party loan repayments.....	(8,910)	-
Debt issuance costs paid.....	(1,465)	(34)
Acquisition of utilities – deferred acquisition payments.....	(11,163)	(4,381)
Net proceeds from the sale of stock.....	-	4,011
Advances in aid of construction.....	760	645
Contributions in aid of construction under ICFA and other agreements.....	2,421	2,513
Refunds of advances for construction.....	(551)	(672)
Net cash provided by (used in) financing activities.....	4,334	(4,571)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS.....	1,583	(7,930)
CASH AND CASH EQUIVALENTS – Beginning of year.....	2,233	10,163
CASH AND CASH EQUIVALENTS – End of year.....	\$ 3,816	\$ 2,233

See accompanying notes to the consolidated financial statements.

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Business** — Global Water Resources, Inc. and its subsidiaries (collectively, the “Company”, “GWRI”, “we”, “us”, or “our”) operates in the Western United States as a water resource management company that owns, operates and manages water, wastewater and recycled water utilities in strategically located communities, principally in metropolitan Phoenix, Arizona. The Company’s model focuses on the broad issues of water supply and scarcity and applies principles of water conservation through water reclamation and reuse. The Company’s basic premise is that the world’s water supply is limited and yet can be stretched significantly through effective planning, the use of recycled water and by providing individuals and communities resources that promote wise water usage practices. The Company deploys its integrated approach, Total Water Management (“TWM”), a term which it uses to mean managing the entire water cycle, both to conserve water and to maximize its total economic and social value. The Company uses TWM to promote sustainable communities in areas where it expects growth to outpace the existing potable water supply. In addition to our regulated utility business, we also have an unregulated business, FATHOM™, which leverages our investment in integrated, cost-saving technology platforms to provide third party services to municipalities and private utilities.

**History** — Global Water Resources, LLC (“GWR”) was organized in 2003 to acquire, own, and manage a portfolio of water and wastewater utilities in the Southwestern United States. Global Water Management, LLC (“GWM”) was formed as an affiliated company to provide business development, management, construction project management, operations, and administrative services to GWR and all of its regulated subsidiaries. Our regulated utilities are regulated by the Arizona Corporation Commission (the “Commission” or “ACC”).

On February 4, 2004, GWR purchased its first two utilities, Santa Cruz Water Company, LLC (“Santa Cruz”) and Palo Verde Utilities Company, LLC (“Palo Verde”). Santa Cruz and Palo Verde provide water and wastewater operations, respectively, to residential and commercial customers in the vicinity of the City of Maricopa in Pinal County, Arizona and are regulated by the ACC. Effective March 31, 2005, GWR purchased the assets of Sonoran Utility Services, LLC (“Sonoran”), an unregulated utility. The Sonoran assets were used to provide water and wastewater operations to residential and commercial customers in a water improvement district and a wastewater improvement district adjacent to the service area of Santa Cruz and Palo Verde. The Sonoran assets were contributed to Santa Cruz and Palo Verde upon acquisition.

In March 2005, Global Water, Inc. (“GWI”), an Arizona corporation, was established as a subsidiary of GWR to acquire, own, and manage a portfolio of water and wastewater utilities. In 2006, Santa Cruz and Palo Verde were reorganized as C corporations and became subsidiaries of GWI.

On July 11, 2006, GWI acquired 100% of the outstanding common shares of West Maricopa Combine (“WMC”), the parent company of Valencia Water Company (“Valencia Water”) in the Town of Buckeye, Willow Valley Water Company (“Willow Valley”) near Bullhead City, Water Utility of Greater Buckeye (“Greater Buckeye”) near the town of Buckeye, Water Utility of Greater Tonopah (“Greater Tonopah”) west of the Hassayampa River, and Water Utility of Northern Scottsdale (“Northern Scottsdale”) in northeast Scottsdale, all within the state of Arizona.

On December 30, 2006, GWI purchased the net assets of CP Water Company (“CP Water”), an Arizona corporation providing water services near the cities of Maricopa and Casa Grande, Arizona. Also, on December 30, 2006, GWI purchased the net assets of Francisco Grande Utility Company (“Francisco Grande”), an Arizona corporation owning the right to provide water and wastewater services near the cities of Maricopa and Casa Grande, Arizona. We applied to have Francisco Grande’s Certificate of Convenience and Necessity (“CC&N”) transferred to Santa Cruz and Palo Verde in 2007. The stock purchase agreement (as amended) included a contingency that the agreement would be terminated if the ACC approval for the transfer of Francisco Grande’s

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

CC&N to us was not received within 36 months after the transfer application was filed at the ACC. During the 36 month period and thereafter, the ACC did not rule on the transfer application. GWRI asserted that since the transfer application was filed on August 20, 2007, the stock purchase agreement terminated on August 20, 2010. The seller initiated an arbitration proceeding to determine if the stock purchase agreement was cancelled. At December 31, 2010, the shares of Francisco Grande were held in escrow pending settlement of the arbitration relating to the ownership of Francisco Grande and ACC approval for the transfer of Francisco Grande's CC&N to GWRI.

In February 2011, the arbitration tribunal decided in favor of the Company; as a result, the escrowed funds were released and the stock of Francisco Grande returned to the seller. The Company's portion of the escrowed funds, amounting to a \$3.2 million letter of credit, was cancelled on March 4, 2011. In addition, as a prevailing party, we were entitled to and received reimbursement of approximately \$197,000 of costs incurred in connection with the arbitration proceedings. As the decision provided additional evidence about conditions that existed as of December 31, 2010, the divestiture of Francisco Grande is reflected in our financial statements as of December 31, 2010.

Francisco Grande had no customers or revenue, although it held some CC&N rights.

GWRI formed Global Water-Picacho Cove Water Company and Global Water-Picacho Cove Utilities Company (collectively, "Picacho") in October 2006, to provide integrated water, wastewater and recycled water service to an area in the vicinity of Eloy, Arizona along Interstate 10 about midway between Tucson and Phoenix. On April 8, 2008, the Commission approved the application for the creation of a CC&N for Picacho to include an area of approximately 1,480 acres with 4,900 homes planned for the initial phase. On July 28, 2009, the Commission approved an expansion application for an additional 2,300 acres planned primarily for a rail served industrial park.

On May 7, 2008, GWRI acquired the net assets of Balterra Sewer Corp. ("Balterra"), an Arizona corporation owning the right to provide wastewater services within western Maricopa County of Arizona. The purchase price consisted of \$1,259,000 plus reimbursement of certain costs, for which a purchase liability was recorded. Further consideration was contingently payable in the form of future growth premiums payable on a per connection basis within the Balterra 208 planning area for 10 years from the closing. At December 31, 2010, the balance of the purchase liability due under the agreement totaled \$215,000. On March 4, 2011, we settled the purchase liability with the seller, including the contingent future growth premiums for \$135,000, resulting in a gain of \$80,000 that was recognized in our statement of operations for the year ended December 31, 2011. The Company also exercised its option to acquire the land assets for \$315,000 in order to construct planned infrastructure for future water and wastewater customers.

**Reorganization** — In early 2010, the members of GWR and GWM made the decision to raise money through the capital markets. The members established a new entity, GWR Global Water Resources Corp. ("GWRC"), which was incorporated under the *Business Corporations Act* (British Columbia) to acquire shares of the Company. On December 30, 2010, GWRC completed its initial public offering in Canada (the "Offering") on the Toronto Stock Exchange, raising gross proceeds totaling C\$65,659,583 (including gross proceeds received January 28, 2011 of C\$4,272,083 pursuant to the underwriters' exercise of their over-allotment option).

In connection with the Offering, GWR and GWM (collectively, "GWRI's predecessor entities") were reorganized to form GWRI (the "Reorganization"). Accordingly, all references herein to GWRI with respect to periods prior to December 30, 2010 should be understood as meaning GWRI's predecessor entities.

In April 2011, GWM, GWRI's subsidiary which owns and operates the Company's FATHOM Utility-to-Utility ("U<sub>2</sub>U<sup>TM</sup>") Solutions ("FATHOM<sup>TM</sup>") business, was reorganized from a limited liability company into Global Water Management, Inc. The reorganization was made to facilitate the growth of FATHOM<sup>TM</sup> by allowing the



**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

entity that owns FATHOM<sup>TM</sup> to hold contractors' licenses in certain states that do not allow limited liability companies to be contractors. The reorganization of GWM had no impact on the consolidated financial statements.

**Basis of Presentation and Principles of Combination** — The consolidated financial statements include the accounts of GWRI and all of its subsidiaries. All intercompany account balances and transactions between GWRI and its subsidiaries have been eliminated.

GWRC is not part of the consolidated Company. GWRC has no employees and GWRI provides for the ongoing management and general administration of substantially all of GWRC's business affairs pursuant to a management agreement between GWRC and GWRI to provide such services.

We prepare our financial statements in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). 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 our reporting currency and the Company's functional currency. Certain previously reported amounts have been reclassified to conform to the current presentation.

**Correction to Consolidated Statements of Cash Flows** — Subsequent to the issuance of the 2011 consolidated financial statements, we determined that acquisition of utilities – deferred acquisition payments of \$4,381,000 previously reported in 2011 as cash used in investing activities within the consolidated statement of cash flows should have been reflected as a financing activity. As a result, this amount has been corrected in the accompanying statement of cash flows for the year ended December 31, 2011. This correction decreased net cash used in investing activities as previously reported from \$11,739,000 to \$7,358,000 for the year ended December 31, 2011, and increased net cash used in financing activities from \$190,000 as previously reported to \$4,571,000 as corrected. This correction has no impact on total cash flows or net cash provided by operating activities.

**Corporate Transactions** — WMC acquisition — On July 11, 2006, we acquired 100% of the outstanding common shares of West Maricopa Combine ("WMC"), the parent company of several of our regulated utilities within the state of Arizona. Under the terms of the related Stock Purchase Agreement, as amended, the purchase price would be paid by the Company over time. In March 2012, we made the final payment for this acquisition in the amount of approximately \$11.9 million.

**Significant Accounting Policies** — Significant accounting policies are as follows:

*Regulation* — Our regulated utilities are subject to regulation by the ACC and are therefore subject to Accounting Standards Codification Topic 980, *Regulated Operations* ("ASC Topic 980").

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. Initial rates are set by the ACC at the time the CC&N is established for an area. The initial rates are determined based on an application submitted by us that includes anticipated customer counts and required infrastructure with rates set to achieve a rate of return on equity invested in the utility. Changes in rates, if any, are made through further formal rate applications.

On September 15, 2010, the ACC issued Rate Decision No. 71878 for the February 2009 filed rate cases for Santa Cruz, Palo Verde, Valencia, Greater Buckeye, Greater Tonopah, and Willow Valley (the "2010 Regulatory Rate Decision"). The Commission established new rates for the utilities effective August 1, 2010, including a phase-in of rates for Palo Verde between August 1, 2010 through January 1, 2012. The rate changes increased rates for

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

water, wastewater and recycled water services for all but one of the utilities, Greater Tonopah, for which rates were reduced.

On July 11, 2012, we filed rate applications with the ACC for seven of our utilities. All of the applications have met the ACC's sufficiency requirements and are currently progressing through the ACC's evaluation process. This evaluation process could take up to one year from the time the applications were deemed sufficient in November 2012. The rate applications request an adjustment to the revenue requirements for all seven utilities representing a collective rate increase of approximately 28%.

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. As of December 31, 2012 and 2011, certain costs associated with our rate cases have been deferred on our balance sheet as regulatory assets as approved by the ACC.

*Property, plant and equipment* — Property, plant and equipment is stated at cost less accumulated depreciation provided on a straight-line basis (see Note 3).

Depreciation rates for asset classes of utility property, plant and equipment are established by the Commission. The cost of additions, including betterments and replacements of units of utility fixed assets are charged to utility property, plant and equipment. When units of utility property are replaced, renewed or retired, their cost plus removal or disposal costs, less salvage proceeds, is charged to accumulated depreciation.

For non-utility property, plant and equipment, depreciation is calculated by the straight-line method over the estimated useful lives of depreciable assets. Cost and accumulated depreciation for non-utility property, plant and equipment retired or disposed of are removed from the accounts and any resulting gain or loss is included in earnings.

In addition to material costs, direct labor and personnel costs, and indirect construction overhead costs may be capitalized. Interest incurred during the construction period is also capitalized as a component of the cost of the constructed assets, which represents the cost of debt associated with construction activity. Expenditures for maintenance and repairs are charged to expense.

*Revenue Recognition — Water Services* — Water services revenues are recorded when service is rendered or water is delivered to customers. However, in addition to the monthly basic service charge, the determination and billing of water sales to individual customers is based on the reading of their meters, which occurs on a systematic basis throughout the month. At the end of each reporting period, amounts of water delivered to customers since the date of the last meter reading are estimated and the corresponding accrued, but unbilled revenue is recorded.

Water connection fees are the fees associated with the application process to set up a customer to receive utility service on an existing water meter. These fees are approved by the ACC through the regulatory process and are set based on the costs incurred to establish services including the application process, billing setup, initial meter reading and service transfer. Because the amounts charged for water connection fees are set by our regulator and not negotiated in conjunction with the pricing of ongoing water service, the connection fees represent the culmination of a separate earnings process and are recognized when the service is provided.

Meter installation fees are the fees charged to the developer or builder associated with the installation of a new water meter. Fees charged for meters installed within a service area regulated by the ACC are refundable pursuant to a utility line extension agreement and properly recorded as a liability. For a portion of our service area, meter

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

installation fees are not refundable. Because these fees are negotiated with the developer or builder independent of service that will be provided to the end-user and represent the culmination of a separate earnings process, they are recognized when the service is rendered. Accordingly, revenue for water meter sales is recognized at the time the water meters are installed.

*Revenue Recognition — Wastewater and Recycled Water Services* — Wastewater service revenues are generally recognized when service is rendered. Wastewater services are billed at a fixed monthly amount per connection, and recycled water services are billed monthly based on volumetric fees.

*Revenue Recognition — Unregulated Revenues* — Unregulated Revenues represent those revenues that are not subject to the ratemaking process of the ACC.

Fees pertaining to our FATHOM<sup>TM</sup> business primarily consist of recurring fees charged to customers on a monthly basis that have been negotiated as either a set fee per mailing (billing) to the utility customers of our FATHOM<sup>TM</sup> customer, or a set fee per month based on the number of meters covered under the respective FATHOM<sup>TM</sup> arrangement. The services we provide for the recurring fees primarily consist of ongoing customer service, billing, collection, meter reading, data analysis, access to the FATHOM<sup>TM</sup> systems, and maintenance, although not all FATHOM<sup>TM</sup> customers have requested the same services. The recurring fees are generally recognized as revenue on a monthly basis provided an arrangement exists, pricing is fixed or determinable, the service to the customer has been provided and collectability is reasonably assured.

Fees associated with the installation of automated meter infrastructure for FATHOM<sup>TM</sup> customers are generally recognized on a percentage of completion basis once total project costs can be estimated, an arrangement exists, pricing is fixed or determinable, and collectability is reasonably assured. Fees associated with the implementation of customer information system (CIS) and asset management solutions for FATHOM<sup>TM</sup> customers are generally recognized as revenue upon completion of the applicable implementation work to the extent that such services have stand-alone value to the customer. Otherwise, CIS and asset management solution implementation fees are deferred and recognized as revenue over the contractual life of the arrangement.

We evaluate FATHOM<sup>TM</sup> agreements to determine if such agreements constitute multiple-element arrangements that include multiple revenue generating activities. Accounting for arrangements that contain more than a single deliverable generally requires a separation-and-allocation model to determine the units of accounting. For arrangements that involve multiple elements (e.g., equipment installation and recurring customer service), the entire fee from the arrangement must be allocated to each of the elements based on the individual element's estimated selling price. Each arrangement requires careful analysis to ensure that all of the individual elements in the arrangement have been identified, along with the estimated selling price of each element and value to the customer on a stand-alone basis. The determination of estimated selling price is based on a hierarchy, starting with vendor specific objective evidence ("VSOE") of the estimated selling price (the price of that element when sold separately), third-party evidence ("TPE"), and, finally management's best estimate of estimated selling price, if VSOE and TPE are not available.

Once the proper amount of revenue for each element is determined, we make an assessment of the appropriate model under which the revenue will be recognized. In making this determination, we consider the nature of services (i.e., consideration of whether the services are essential to the functionality of the product), availability of services from other vendors, timing of payments and impact of milestones or acceptance criteria, if any, on the collectability of the arrangement fees.

In addition to revenues from FATHOM<sup>TM</sup> agreements, the Company's Unregulated business generates gains by selling the contractual rights to receive future refunds associated with line extension agreements of GWRI's

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

regulated utilities. As discussed in *Advances and Contributions in Aid of Construction* below, our regulated utilities have various agreements with real estate developers and builders (the “Developers”), whereby funds, water line extensions, or wastewater line extensions are provided to us by the Developers and are considered refundable advances for construction. We continually look for opportunities where Developers are willing to sell their rights to receive refunds under such agreements for a discounted lump-sum payment. Once the Company acquires the refund rights from the Developer, we are then able to transfer such rights to third parties interested in a long-term stream of refund payments. Typically, we purchased these contractual rights from the respective Developer immediately before we completed the sales of those rights. The difference between the proceeds we receive and the amounts we paid to the developer is recognized as a gain and presented as a component of unregulated revenue when all of the following criteria exist: an arrangement exists, pricing is fixed or determinable, the transfer of the rights from the Developer to the Company and from the Company to the buyer has occurred, and collectability is reasonably assured. These gains have been included within operating income as we view the activity as a new line of business and the Company has the ability and intent to pursue opportunities of similar transactions in the future.

*Allowance for Doubtful Accounts* — Provisions are made for doubtful accounts due to the inherent uncertainty around the collectability of accounts receivable. The allowance for doubtful accounts is recorded as bad debt expense, and is classified as general and administrative expense. The allowance for doubtful accounts is determined considering the age of the receivable balance, type of customer (e.g., residential, commercial), payment history as well as specific identification of any known or expected collectability issues (see Note 4).

*Infrastructure coordination and financing fees* — Infrastructure coordination and financing agreements (“ICFAs”) are agreements with developers and homebuilders where GWRI 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 provide physical capacity for water and wastewater to the landowner/developer. 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 as a lien against the land and must be assumed in the event of a sale or transfer. 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 over the period that 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 GWRI’s ability to provide fitted capacity for water and wastewater service.

As discussed above, during 2010 the ACC issued its rate decision for several of the Company’s utilities. The 2010 Regulatory Rate Decision established new rates for the recovery of reasonable costs incurred by the utilities. In determining the new annual revenue requirement, the ACC removed from allowable costs amounts related to ICFA funds collected by the Company that the ACC deemed to be *Contributions in Aid of Construction* (“CIAC”) for rate making purposes. In addition, there was an imputed reduction in rate base for the amount deemed as CIAC. As a result of the decision by the ACC, GWRI has changed its accounting policy for the accounting of ICFA funds. Effective January 1, 2010, GWRI records ICFA fees received as CIAC. The ICFA-related CIAC will be amortized as a reduction of depreciation expense over the estimated depreciable life of the utility plant at the related utilities. Refer to Note 12 for additional discussion regarding ICFAs.

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Cash and Cash Equivalents* — Cash and cash equivalents include all highly liquid investments in debt instruments with an original maturity of three months or less.

*Restricted Cash* — Restricted cash represents cash deposited as a debt service reserve for certain loans and bonds. The deposits must stay in place until the respective debts have been fully repaid.

*Income Taxes* — The Company utilizes the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company's valuation allowance totaled \$33.7 million and \$0 as of December 31, 2012 and 2011, respectively (see Note 8).

We evaluate uncertain tax positions using a two-step approach. Recognition (step one) occurs when we conclude that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) determines the amount of benefit that more-likely-than-not will be realized upon settlement. Derecognition of a tax position that was previously recognized would occur when we subsequently determine that a tax position no longer meets the more-likely-than-not threshold of being sustained. The use of a valuation allowance as a substitute for derecognition of tax positions is prohibited, and to the extent that uncertain tax positions exist, we provide expanded disclosures.

*Goodwill* — Goodwill represents the excess of acquisition cost over the fair value of net tangible and identifiable intangible assets acquired in business combinations. Goodwill is tested for impairment at least annually on October 1 and more frequently if circumstances indicate that it may be impaired. Goodwill impairment testing is performed at the reporting unit level. The goodwill impairment model is a two-step process. First, it requires a comparison of the book value of net assets to the fair value of the related operations that have goodwill assigned to them. We use the terminal valuation method in estimating fair value which assumes a business will be sold at the end of the projection period at a specific terminal value. Earnings and discounted cash flows were developed from our internal forecasts. Additionally, management must make an estimate of a weighted-average cost of capital to be used as a company-specific discount rate, which takes into account certain risk and size premiums, risk-free yields, and the capital structure of the industry. We have also considered other qualitative and quantitative factors including the regulatory environment that can significantly impact future earnings and cash flows and the effects of the volatile current economic environment. Changes in these projections or estimates could result in a reporting unit either passing or failing the first step in the goodwill impairment model.

If the fair value of a reporting unit is determined to be less than book value, a second step is performed to determine if goodwill is impaired, and if so, the amount of such impairment. In this process, an implied fair value for goodwill is estimated by allocating the fair value of the reporting unit to the applicable reporting unit's assets and liabilities resulting in any excess fair value representing the implied fair value of goodwill. The amount by which carrying value exceeds the implied fair value represents the amount of goodwill impairment (see Note 5).

*Intangible Assets* — Intangible assets not subject to amortization consist of certain permits expected to be renewable indefinitely, water rights and certain service areas acquired in transactions which did not meet the definition of business combinations for accounting purposes, and are considered to have indefinite lives. Intangible assets with indefinite lives are not amortized but are tested for impairment annually, or more often if certain



**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

circumstances indicate a possible impairment may exist. Amortized intangible assets consist primarily of acquired ICFA contract rights.

Effective January 1, 2010 and in connection with the 2010 Regulatory Rate Decision whereby ICFA funds received are accounted for as CIAC, the Company established a regulatory liability of \$12.1 million against the Company's intangible assets balance. The regulatory liability effectively offsets the value of the intangible assets that were recorded for the expected receipt of ICFA fees in the future (see Note 5).

*Debt Issuance Costs* — In connection with the issuance of some of our long-term debt, we have incurred legal and other costs that we believe are directly attributable to realizing the proceeds of the debt issued. These costs are capitalized in other assets and amortized as interest expense using the effective interest method over the term of the respective debt. Amortization of debt issuance costs and discounts totaled \$353,000 and \$243,000 for the years ended December 31, 2012 and 2011, respectively.

*Impairment of Long-Lived Assets* — Management evaluates the carrying value of long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. If an indicator of possible impairment exists, an undiscounted cash flow analysis would be prepared to determine whether there is an actual impairment. Measurement of the impairment loss is based on the fair value of the asset. Generally, fair value will be determined using appraisals or valuation techniques such as the present value of expected future cash flows.

*Advances and Contributions in Aid of Construction* — The Company has various agreements with Developers and builders, whereby funds, water line extensions, or wastewater line extensions are provided to us by the Developers and are considered refundable advances for construction. These advances in aid of construction ("AIAC") are non-interest-bearing and are subject to refund to the Developers through annual payments that are computed as a percentage of the total annual gross revenue earned from customers connected to utility services constructed under the agreement over a specified period. Upon the expiration of the agreements' refunding period, the remaining balance of the advance becomes nonrefundable and at that time is considered contributions in aid of construction ("CIAC"). CIAC are amortized as a reduction of depreciation expense over the estimated remaining life of the related utility plant. For rate-making purposes, utility plant funded by advances and contributions in aid of construction are excluded from rate base.

As indicated above, pursuant to the 2010 Regulatory Rate Decision, the Company also accounts for funds received under ICFA agreements as CIAC. The balance of ICFA-related CIAC, net of accumulated amortization, totaled \$64.8 million and \$62.8 million as of December 31, 2012 and 2011, respectively.

*Fair Value of Financial Instruments* — The carrying values of cash equivalents, trade receivables, and accounts payable approximate fair value due to the short-term maturities of these instruments. See Note 7 for information as to the fair value of our long-term debt. Our refundable advances in aid of construction have a carrying value of \$100.2 million and \$105.3 million at December 31, 2012 and 2011, respectively. Portions of these non-interest-bearing instruments are payable annually through 2032 and amounts not paid by the contract expiration dates become nonrefundable. Their relative fair values cannot be accurately estimated because future refund payments depend on several variables, including new customer connections, customer consumption levels, and future rate increases. However, the fair value of these amounts would be less than their carrying value due to the non-interest-bearing feature.

*Asset Retirement Obligations* — Liabilities for asset retirement obligations are typically recorded at fair value in the period in which they are incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. Our legal obligations for retirement reflect principally the retirement of wastewater treatment facilities, which are required to be closed in accordance with the Clean Closure Requirements of the Arizona Department of Environmental Quality (ADEQ). The Clean Closure Requirements of ADEQ for wastewater facilities are driven by a need to protect the environment from inadvertent contamination associated with the decommissioning of these systems. As such, our regulated subsidiaries incur asset retirement obligations. We have provided \$229,000 of certificates of deposit or letters of credit to benefit ADEQ for such anticipated closure costs. Water systems, unlike wastewater systems, do not require Aquifer Protection Permits or the associated Clean Closure Requirement obligation.

Amounts recorded for asset retirement obligations are subject to various assumptions and determinations, such as determining whether a legal obligation exists to remove assets; estimating the fair value of the costs of removal; estimating when final removal will occur; and determining the credit-adjusted, risk-free interest rates to be utilized on discounting future liabilities. Changes that may arise over time with regard to these assumptions will change amounts recorded in the future. Estimating the fair value of the costs of removal were determined based on third-party costs.

## **2. NEW ACCOUNTING PRONOUNCEMENTS**

### **Recently Adopted Standards**

*Testing Indefinite-Lived Intangible Assets for Impairment* - In July 2012, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2012-02, *Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment* (ASU 2012-02). ASU 2012-02 simplifies the guidance for testing the decline in the realizable value (impairment) of indefinite-lived intangible assets other than goodwill by allowing an organization the option to first assess qualitative factors to determine whether it is necessary to perform the quantitative impairment test. An organization electing to perform a qualitative assessment is no longer required to calculate the fair value of an indefinite-lived intangible asset unless the organization determines, based on a qualitative assessment, that it is "more likely than not" that the asset is impaired. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. We do not expect the adoption of ASU 2012-02 will have a material impact on our consolidated financial statements.

*Testing Goodwill for Impairment* - In September 2011, the FASB issued ASU No. 2011-08, *Intangibles—Goodwill and Other (Topic 350)—Testing Goodwill for Impairment* (ASU 2011-08), to allow entities to use a qualitative approach to test goodwill for impairment. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. We adopted ASU 2011-08 on January 1, 2012, but did not use a qualitative approach to test goodwill for impairment. The standard did not have a significant impact on our consolidated financial statements.

*Presentation of Comprehensive Income* - In June 2011, the FASB issued guidance on the presentation of comprehensive income. This guidance eliminates the option of presenting components of other comprehensive income as part of the statement of changes in stockholders' equity. The guidance gives entities the option to present the total of comprehensive income, the components of net income and the components of other comprehensive income in either a single continuous statement of comprehensive income or in two separate but consecutive statements. In December 2011, the FASB issued an amendment to indefinitely defer one of the requirements

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

contained in its June 2011 final standard. That requirement called for reclassification adjustments from accumulated other comprehensive income to be measured and presented by income statement line item in net income and also in other comprehensive income. This guidance, including the related deferral, is effective for fiscal years and interim periods beginning after December 15, 2011 and must be applied retrospectively. We adopted this guidance on January 1, 2012; however, this guidance will only impact our consolidated financial statements if we have components of comprehensive income besides net income in the future. Therefore, no statement of comprehensive income has been included.

**3. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment at December 31, 2012 and 2011 consist of the following (in thousands of US\$):

	December 31, 2012	December 31, 2011	Average Depreciation Life (in years)
PROPERTY, PLANT AND EQUIPMENT:			
Mains/lines/sewers .....	\$ 135,631	\$ 135,252	47
Plant .....	78,689	78,421	25
Utility equipment .....	41,582	41,224	10
Meters.....	5,898	5,786	12
Furniture, fixture and leasehold improvements....	1,176	1,170	8
Computer and office equipment.....	2,729	2,773	5
Software.....	6,395	4,439	3
Land and land rights .....	977	933	
Other.....	139	207	
Construction work-in-process .....	48,481	47,599	
Total property, plant and equipment .....	321,697	317,804	
Less accumulated depreciation.....	(61,461)	(51,856)	
Net property, plant and equipment.....	\$ 260,236	\$ 265,948	

**4. ACCOUNTS RECEIVABLE**

Accounts receivable at December 31, 2012 and 2011 consist of the following (in thousands of US\$):

	December 31, 2012	December 31, 2011
Billed receivables .....	\$ 2,132	\$ 2,985
Less allowance for doubtful accounts.....	(206)	(206)
Accounts receivable – net.....	\$ 1,926	\$ 2,779

**5. GOODWILL AND INTANGIBLE ASSETS**

The carrying value of goodwill totaled \$13,082,000 as of December 31, 2012 and 2011. The Company has completed its 2012 annual impairment assessment and determined that the goodwill balance was not impaired. Since inception, we have recorded \$32,727,000 of goodwill impairment, all of which relates to Greater Tonopah.



**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Intangible assets at December 31, 2012 and 2011 consist of the following (in thousands of US\$):

	December 31, 2012			December 31, 2011		
	<u>Gross Amount</u>	<u>Accumulated Amortization</u>	<u>Net Amount</u>	<u>Gross Amount</u>	<u>Accumulated Amortization</u>	<u>Net Amount</u>
INDEFINITE LIVED INTANGIBLE ASSETS:						
CP Water CC&N 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	(11,405)	6,573	17,978	(11,405)	6,573
Sonoran contract rights .....	7,406	(2,003)	5,403	7,406	(2,003)	5,403
Regulatory liability .....	(12,117)	141	(11,976)	(12,117)	141	(11,976)
	<u>13,267</u>	<u>(13,267)</u>	<u>-</u>	<u>13,267</u>	<u>(13,267)</u>	<u>-</u>
Total intangible assets.....	<u>\$ 14,812</u>	<u>\$ (13,267)</u>	<u>\$ 1,545</u>	<u>\$ 14,812</u>	<u>\$ (13,267)</u>	<u>\$ 1,545</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. Such amortization is offset by a corresponding reduction of the regulatory liability in the same amount. There was no amortization expense for the year ended December 31, 2012 and 2011. Due to the uncertainty of the timing of when cash will be received under ICFA agreements, we cannot accurately estimate when the remaining intangible assets amortization will be recorded.

## 6. TRANSACTIONS WITH RELATED PARTIES

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 \$542,000 and \$399,000 during 2012 and 2011, respectively. We also obtain legal services from a law firm in which one of our shareholders and former director has an interest. Total legal fees paid to this law firm were \$29,000 and \$567,000 for the years ended December 31, 2012 and 2011, respectively.

As discussed in Note 1, in July 2006, we acquired WMC and its related entities. Under the terms of the related Stock Purchase Agreement, as amended, the purchase price would be paid by the Company over time, with the final acquisition payment totaling approximately \$11.9 million due March 31, 2012. In March 2012, we issued a \$9.4 million promissory note to Levine Investments Limited Partnership, which is owned and controlled by a shareholder and a director of the Company. Approximately \$8.9 million of the proceeds was paid to the sellers of WMC. The remaining \$0.5 million of the promissory note represented an incentive for entering into the arrangement. The promissory note was scheduled to be repaid over 24 consecutive months starting May 1, 2012 including principal and interest. However, in June 2012, the promissory note was repaid in full with a portion of the proceeds from the June 2012 financing transactions discussed in Note 7.

GWRC is economically dependent on the Company. Under the management agreement between GWRC and the Company, the Company provides management and general administration services to GWRC. Services provided by the Company are provided at no charge to GWRC, and are not monetarily significant. However, GWRC does incur certain costs not covered by the management agreement. These include GWRC's accounting fees, listing fees and other costs directly associated with operating as a publicly traded company. However, whereas GWRC has no cash and does not expect to generate cash flows from operating activities, the operating costs incurred by GWRC are paid by the Company until such time that GWRC receives cash from dividends on its investment in the Company or through issuing additional equity or debt securities in the market. Through December 31, 2012,

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

amounts paid by the Company on GWRC's behalf totaled \$563,000. The Company previously reported the amount paid for GWRC as a receivable from the related party. However, since the Company is not able to objectively determine when the related party receivable will be settled, the receivable has been reclassified to equity (effectively presented as a distribution to GWRC) as of December 31, 2012.

**7. DEBT**

The outstanding balances and maturity dates for short-term (including the current portion of long-term debt) and long-term debt as of December 31, 2012 and 2011 are as follows (in thousands of US\$):

	<b>December 31, 2012</b>		<b>December 31, 2011</b>	
	<b>Short-term</b>	<b>Long-term</b>	<b>Short-term</b>	<b>Long-term</b>
<b>BONDS PAYABLE –</b>				
5.450% Series 2006, maturing December 1, 2017.....	\$ 835	\$ 3,835	\$ 790	\$ 4,670
5.600% Series 2006, maturing December 1, 2022.....	-	6,215	-	6,215
5.750% Series 2006, maturing December 1, 2032.....	-	23,370	-	23,370
5.500% Series 2007, maturing December 1, 2013.....	575	-	545	575
6.550% Series 2007, maturing December 1, 2037 – net of unamortized discount of \$400 and \$421 at December 31, 2012 and 2011, respectively.....	-	52,100	-	52,078
6.375% Series 2008, maturing December 1, 2018.....	165	995	155	1,160
7.500% Series 2008, maturing December 1, 2038.....	-	23,235	-	23,235
Variable – 65% of LIBOR plus 2.92% Series 2012A, maturing December 1, 2021.....	490	6,808	-	-
Variable - LIBOR plus 3.00% Series 2012B, maturing December 1, 2021.....	410	5,692	-	-
	<u>2,475</u>	<u>122,250</u>	<u>1,490</u>	<u>111,303</u>
<b>LINE OF CREDIT –</b>				
3.750% at December 31, 2011.....	-	-	4,010	-
<b>TERM LOAN –</b>				
LIBOR plus 3.25% Regions Term Loan, maturing December 1, 2021.....	600	10,300	-	-
<b>WIFA LOANS –</b>				
6.125% WIFA 920010-98, maturing September 2018.....	-	-	14	92
5.810% WIFA 920024-99, maturing June 2019.....	-	-	4	29
4.688% WIFA 920072-03, maturing November 2022.....	-	-	3	33
4.375% WIFA 920071-03, maturing November 2022.....	-	-	5	59
4.375% WIFA 920078-03, maturing December 2022.....	-	-	5	64
6.750% WIFA 920102-06, maturing June 2026.....	-	-	127	1,879
6.650% WIFA 920103-06, maturing October 2026.....	-	-	5	76
6.650% WIFA 920104-06, maturing November 2026.....	-	-	21	356
4.200% WIFA 92A170-10, maturing September 2029.....	-	-	58	1,341
4.200% WIFA 92A179-10, maturing November 2029.....	-	-	10	232
	<u>-</u>	<u>-</u>	<u>252</u>	<u>4,161</u>
<b>OTHER LOANS –</b>				
8.000% Garcia loan, maturing January 2015.....	5	7	5	12
Capital lease obligation.....	123	213	-	-
<b>Total debt.....</b>	<u>\$ 3,203</u>	<u>\$ 132,770</u>	<u>\$ 5,757</u>	<u>\$ 115,476</u>

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Tax Exempt Bonds* – We issued tax exempt bonds through The Industrial Development Authority of the County of Pima in the amount of \$36,495,000 on December 28, 2006; \$53,624,000, net of a discount of \$511,000, on November 19, 2007; and \$24,550,000 on October 1, 2008. The Series 2006, 2007 and 2008 Bonds have interest payable semiannually on the first of June and December. Recurring annual payments of principal are payable annually on the first of December for the Series 2006, 2007 and 2008 Bonds. Proceeds from these bonds were used for qualifying costs of constructing and equipping the water and wastewater treatment facilities of our subsidiaries, Palo Verde Utilities Company (Palo Verde) and Santa Cruz Water Company (Santa Cruz). The Company has not granted any deed of trust, mortgage, or other lien on property of Santa Cruz or Palo Verde. The Bonds are secured by a security agreement that gives the trustee rights to the net operating income generated by our Santa Cruz and Palo Verde utilities.

*WIFA Loans* – We previously received various loans from the Water Infrastructure Finance Authority of Arizona (WIFA), an independent agency of the state of Arizona authorized to finance the construction, rehabilitation and/or improvement of drinking water, wastewater, wastewater reclamation, and other water quality facilities and projects. Generally, WIFA offers borrowers below market interest rates on loans for 100% of eligible project costs. The loans were secured by the underlying assets of the borrowing entities. The WIFA loans were repaid in full in August 2012 (see “2012 Financings” below).

*Revolving Line of Credit* – On March 24, 2011, we entered into a revolving line of credit arrangement, providing the Company a working capital borrowing facility of up to \$5,000,000, with a \$250,000 stand-by letter of credit sublimit. The line of credit contained an interest option of Prime plus 0.50% or LIBOR plus 3.00% and was collateralized by the stock of the Company’s subsidiaries and assets of GWM. Borrowings under the revolving line of credit totaled \$4,010,000 as of December 31, 2011, and were repaid in March 2012 at maturity.

*Term Loan* – On March 22, 2012, we entered into a secured term credit facility with Regions Bank under which the Company borrowed \$7,000,000. The secured term credit facility which was scheduled to mature in March 2013, contained an interest rate of LIBOR plus 2.50% and was collateralized by the stock and net operating income (as defined in the credit facility) of certain of our subsidiaries, and the assets of FATHOM<sup>TM</sup>. The secured term credit facility had financial covenants requiring (i) the Company maintain a minimum Debt Service Coverage Ratio, tested on a consolidated basis for each consecutive four fiscal quarter period, (Debt Service Coverage Ratio is defined as EBITDA divided by the annual consolidated debt service requirements during such four fiscal quarter period) of 1.10:1.00; (ii) the Company to have a minimum liquidity of \$1,500,000 as of the last day of each fiscal quarter; and (iii) the Company maintain Fixed Charge Coverage ((EBITDA-Cash Taxes-Unfinanced Capex) / (Annual Consolidated Debt Service requirements + Distributions)) of 1.00:1.00, tested on a consolidated basis for each consecutive four fiscal quarter period.

On March 23, 2012, approximately \$4.0 million of the proceeds from the secured term credit facility was used to extinguish our revolving line of credit balance. The remaining \$3.0 million of proceeds was paid to the selling party to which we owed deferred acquisition payments related to our 2006 acquisition of WMC (see Note 1). This secured term credit facility was fully repaid on June 29, 2012.

*2012 Financings* – On June 29, 2012, we secured \$25,000,000 of financing consisting of \$7,625,000 of tax-exempt revenue bonds (the “Series 2012A Bonds”) and \$6,375,000 taxable revenue bonds (the “Series 2012B Bonds”) through The Industrial Development Authority of the County of Pima, and an \$11,000,000 term loan through Regions Bank (the “2012 Term Loan”). With the proceeds from these financings we retired the \$7.0 million term loan with Regions Bank and the balance of the \$9.4 million promissory note with a related party (see Note 6). Additionally, approximately \$4.0 million of the proceeds was deposited into an escrow account and was used to repay the WIFA loans in full in August 2012.

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

These loans have semiannual interest payments and annual principal payments, which commenced December 1, 2012. The Series 2012A Bonds accrue interest at a rate of 65% of LIBOR plus 242 or 292 basis points (“bps”) depending on debt service coverage ratios, and the Series 2012B Bonds accrue interest at a rate of LIBOR plus 250 or 300 bps. The 2012 Term Loan accrues interest at a rate of LIBOR plus 325 bps. At December 31, 2012, the effective interest rates on the Series 2012A Bonds, the Series 2012B Bonds and the 2012 Term Loan were approximately 3.25%, 3.35% and 3.76%, respectively. The Company evaluated its options regarding interest rate protection on the variable rate bond debt, and on September 14, 2012, entered into rate cap transaction agreements with the Regions Bank. These agreements qualify as derivative instruments and are recorded at fair value. In total, the instruments cost \$72,000. As of December 31, 2012, the instruments were revalued to \$123,000, with the mark-to-market adjustment recorded as a reduction to interest expense.

These loans have financial covenants requiring, (a) the Company maintain a Fixed Charge Coverage Ratio ((EBITDA-Cash Taxes-Unfinanced Capex) / (Annual Consolidated Debt Service requirements + Distributions)) of 1.00:1.00, tested on a consolidated basis for each consecutive four fiscal quarter period; (b) the Company maintain a minimum Debt Service Coverage Ratio of 1.10:1.00, tested on a consolidated basis for each consecutive four fiscal quarter period; (c) the Company have a minimum liquidity level of Cash and Cash Equivalents of 60 days; (d) the Company maintain a debt service reserve fund (i) in the amount of \$626,000 for the 2012 Term Loan; and (ii) equal to the least of (1) 10% of the outstanding principal amount of the Series 2012A and Series 2012B Bonds, (2) 100% of maximum annual debt service on the Series 2012A and Series 2012B Bonds, and (3) 110% of the average annual debt service on the Series 2012A and Series 2012B Bonds. These covenants are required to be tested on a consolidated basis as of the last day of each fiscal quarter.

For the Series 2006, 2007, 2008, 2012A and 2012B Bonds, we are required to maintain a debt service reserve fund. The balance in the debt service reserve fund for the Series 2006, 2007 and 2008 Bonds totaled \$8,776,000 at December 31, 2011. The Series 2012A and Series 2012B Bonds rank on parity with the earlier bond issues and therefore the combined debt service reserve fund was increased to \$10,654,000 as of December 31, 2012. Since the initial bond issuance in 2006 and upon the trustee’s discretion, the Company has only been required to fund up to 90% of the required fund balance for compliance purposes.

In the fourth quarter of 2012, we failed to meet our Fixed Charge Coverage Ratio requirement. The Company notified Regions Bank of the covenant violation that would have caused an event of default, and the Company and Regions Bank then entered into an amended 2012 Term Loan agreement (the “Amended 2012 Term Loan”) effective December 31, 2012. The Amended 2012 Term Loan contains certain terms, including, (i) the Company’s failure to maintain a Fixed Charge Coverage Ratio of at least 1.00:1.00 from December 31, 2012 through April 1, 2014 shall not constitute an event of default; (ii) beginning with the fiscal quarter ending December 31, 2012 through April 1, 2014, the Company must maintain a minimum liquidity level of 20 days of cash on hand. Thereafter, the Company shall maintain a minimum liquidity level of 60 days of cash on hand; (iii) failure to maintain the minimum Consolidated Fixed Charge Coverage Ratio or days cash on hand requirements at the end of each Fiscal Quarter beginning on December 31, 2012 will result in an increase in interest rate by 57 basis points for each respective quarterly failure. Each such quarterly increase to the interest rate shall be cumulative; (iv) the Company shall make monthly deposits into a debt service fund in an amount equal to 1/12th of the annual principal and 1/6th of the semi-annual interest coming due under the 2012 Financing arrangements for application by Regions Bank upon such annual principal and semi-annual interest becoming due. The Company grants and assigns to Regions Bank a first-priority security interest in the debt service fund; and (v) an emergency capital expenditure reserve fund will be established and the proceeds expected to be received from Sierra Negra Ranch LLC pursuant to a certain arbitration award (see Note 12) will be deposited into the fund with Regions Bank having a first-priority security interest in the fund.

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Amended 2012 Term Loan also specifies that the Fixed Charge Coverage Ratio and the minimum liquidity level be separately calculated for the Company exclusive of GWM, the entity that owns FATHOM™. Under this provision, the Amended 2012 Term Loan requires the Company maintain the Fixed Charge Coverage Ratio of no less than 1.00:1.00 and maintain a minimum liquidity level of no less than 60 days of cash on hand.

Capital Lease - On July 27, 2012, the Company entered into an agreement to lease computer storage equipment valued at \$387,000. The 36-month lease agreement has been classified as a capital lease and obligates the Company to \$426,000 of lease payments starting August 28, 2012. At December 31, 2012, the total liability balance relating to the capital lease obligation was \$336,000, with \$123,000 of the liability classified as current and the remaining \$213,000 classified as non-current. At December 31, 2012, the total obligation for future minimum lease payments was \$367,000 with \$31,000 attributed to interest.

At December 31, 2012, 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 of US\$):

	Debt	Capital Lease Obligations
2013 .....	\$ 3,080	\$ 142
2014 .....	4,086	142
2015 .....	4,476	83
2016 .....	4,835	-
2017 .....	4,945	-
Thereafter .....	114,615	-
Subtotal .....	\$ 136,037	\$ 367
Less: amount representing interest .....	-	(31)
Total .....	<u>\$ 136,037</u>	<u>\$ 336</u>

At December 31, 2012, the carrying value of the non-current portion of long-term debt was \$133.2 million, with an estimated fair value of \$143.9 million. The carrying value of the non-current portion of long-term debt was \$115.5 million on December 31, 2011, with an estimated fair value of \$127.8 million. The fair value of our debt was estimated based on interest rates considered available for instruments of similar terms and remaining maturities.

In addition to interest on our long-term debt, we recorded interest related to the accretion of the purchase liability associated with our WMC acquisition which was extinguished in March 2012 (see Note 1). Such interest expense totaled \$187,000 and \$801,000 during the years ended December 31, 2012 and 2011, respectively.

## **8. INCOME TAXES**

Certain assets and liabilities are reported differently for income tax purposes than for financial statement purposes. The tax effect of these differences is recorded as deferred taxes. We calculate deferred taxes using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. We have no significant unrecognized tax benefits.

The Company accounts for income taxes by recognizing deferred tax assets and liabilities based upon temporary differences between the financial reporting and tax basis of its assets and liabilities. According to the guidelines prescribed in the FASB's Accounting Standards Codification (ASC) 740, *Income Taxes*, valuation allowances should be established to reduce deferred tax assets when it is more-likely-than-not that a portion or all of the deferred tax assets will not be realized. The Company routinely considers whether a valuation allowance should be recorded against its deferred tax assets.

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The income tax expense (benefit) from continuing operations for the years ended December 31, 2012 and 2011 is comprised of (in thousands of US\$):

	<b>2012</b>	<b>2011</b>
Current income tax expense (benefit) .....	\$ -	\$ -
Deferred income tax expense (benefit) .....	30,667	(1,972)
Income tax expense (benefit) .....	<u>\$ 30,667</u>	<u>\$ (1,972)</u>

The income tax expense (benefit) for the years ended December 31, 2012 and 2011 differs from the amount that would be computed using the federal statutory income tax rate due to the following (in thousands of US\$):

	<b>2012</b>	<b>2011</b>
Computed federal tax (benefit) expense at statutory rate .....	\$ (2,657)	\$ (1,795)
State income taxes - net of federal tax benefit .....	(364)	(231)
Valuation allowance <sup>(1)</sup> .....	33,668	-
Other — net .....	20	54
Income tax expense (benefit) .....	<u>\$ 30,667</u>	<u>\$ (1,972)</u>

- (1) The ASC prescribes the method to determine whether a deferred tax asset is realizable and significant weight is given to evidence that can be objectively verified. During 2012, as a result of the cumulative losses experienced over the prior three years, which under the accounting standard represents significant objective negative evidence and prohibits the Company from considering projected income, we concluded that a full valuation allowance be recorded against our net deferred tax assets. At December 31, 2012, the valuation allowance totaled approximately \$33.7 million. To the extent that the Company generates taxable income in the future, the valuation allowance may be reduced to fully or partially offset the corresponding income tax expense. Any remaining deferred tax asset valuation allowance may ultimately reverse through income tax expense when the Company can demonstrate a sustainable return to profitability.



**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes the Company's temporary differences between book and tax accounting that give rise to the deferred tax assets and deferred tax liabilities, including the valuation allowance, as of December 31, 2012 and 2011 (in thousands of US\$):

	<u>December 31, 2012</u>	<u>December 31, 2011</u>
<b>DEFERRED TAX ASSETS:</b>		
Taxable meter deposits .....	\$ 668	\$ 617
Net operating loss carry forwards .....	11,565	10,483
Balterra intangible asset acquisition .....	349	349
WMC acquisition liability .....	-	132
Contributions in aid of construction.....	25,065	24,292
Intangible assets .....	2,282	2,661
Other .....	680	428
Total deferred tax assets	<u>40,609</u>	<u>38,962</u>
<b>DEFERRED TAX LIABILITIES:</b>		
Property, plant and equipment .....	(1,752)	(3,184)
Deferred gain on sale of assets - discontinued operations .....	(5,189)	(5,114)
CP Water intangible asset acquisition .....	<u>(589)</u>	<u>(593)</u>
Total deferred tax liabilities .....	(7,530)	(8,891)
Valuation allowance .....	(33,668)	-
Net deferred tax asset (liability) .....	<u>\$ (589)</u>	<u>\$ 30,071</u>

As of December 31, 2012, we have approximately \$29.9 million in federal and state net operating loss ("NOL") carry forwards available to offset future taxable income, with approximately \$26.3 million expiring in 2028-2032 for the federal return and \$3.6 million expiring in 2013-2017 for the state return.

After the recording of the valuation allowance discussed above, the remaining net deferred tax liability of \$589,000 at December 31, 2012 represents the book and tax temporary difference related to an indefinite-lived intangible asset recorded in connection with our acquisition of CP Water, which temporary difference will not reverse unless the Company divests itself of that entity.

## 9. SHAREHOLDERS' EQUITY

As discussed in Note 1, during 2010, GWRI was reorganized and the Company coordinated the formation and initial public offering of GWRC. In connection with the Offering, GWRC acquired 81,850 shares of the Company's common stock for an approximately 46.1% interest in the Company.

On January 28, 2011, the underwriters of the Offering exercised their over-allotment option and GWRC used the \$4,011,000 of net proceeds of the over-allotment to purchase an additional 5,696 shares of the Company's common stock, increasing GWRC's interest in the Company to approximately 48.1%.

## 10. 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.

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

At December 31, 2012 and 2011, there were options to acquire 431 shares of common stock of GWRI outstanding. The options were all vested and exercisable at December 31, 2012. The stock options have a remaining contractual life of approximately 5.50 years and have an exercise price of \$870.66 per share.

*GWRC stock option grant* – In January 2012, GWRC’s Board of Directors granted options to acquire 385,697 GWRC common shares to nine employees of GWRI in lieu of paying cash bonuses for 2011. The options vest in equal installments over the eight quarters of 2012 and 2013, with exercise prices of C\$7.50 and C\$4.00 per share and expire four years after the date of issuance. We account for the GWRC option grant in accordance with ASC 323, *Investment-Equity Method & Joint Ventures*. At December 31, 2012, the estimated fair value of the unvested options was \$33,000. The Company remeasures the fair value of the award at the end of each period until the options are fully vested.

Stock-based compensation expense recorded during the years ended December 31, 2012 and 2011 totaled \$118,000 and \$41,000, respectively.

**Phantom stock compensation** – On December 30, 2010, we adopted a phantom stock unit plan (the “PSU Plan”) authorizing the directors of the Company to issue phantom stock units (“PSUs”) to our employees. The value of the PSUs issued under the plan track the performance of GWRC’s shares and give rise to a right of the holder to receive a cash payment the value of which, on a particular date, will be the market value of the equivalent number of shares of GWRC at that date. The issuance of PSUs as a core component of employee compensation is intended to strengthen the alignment of interests between the employees of the Company and the shareholders of GWRC by linking their holdings and a portion of their compensation to the future value of the common shares of GWRC.

In connection with the Reorganization, 350,000 PSUs were issued to members of management on December 30, 2010, with an initial value of approximately \$2.6 million. PSUs are accounted for as liability compensatory awards under ASC 710, *Compensation – General*, rather than as equity awards. The PSU awards are remeasured each period based on the present value of the benefits expected to be provided to the employee upon vesting. The present value of the benefits is recorded as expense in the Company’s financial statements over the related vesting period. The December 30, 2010 PSUs vest at the end of four years from the date of their issuance. Accordingly, the value of the PSU will be paid to the holder on the fourth anniversary of the award grant date. There is no exercise price attached to PSU awards.

In January 2012, 135,079 additional PSUs were issued to nine members of management as a reward for performance in 2011. The PSUs issued to management vest ratably over 12 consecutive quarters beginning January 1, 2012 and are accounted for as liability compensatory awards similar to the PSUs issued in December 2010. These PSUs will be remeasured each period and a liability will be recorded equal to GWRC’s closing share price on the period end date multiplied by the number of units vested.

The Company recorded approximately \$235,000 and \$418,000 of compensation expense for the years ended December 31, 2012 and 2011. Based on GWRC’s closing share price on December 31, 2012, deferred compensation expense related to PSUs outstanding as of December 31, 2012 to be recognized in future periods is estimated for the years ending December 31 as follows (in thousands of US\$):

2013 .....	124
2014 .....	149
Total.....	<u>\$ 273</u>

In January 2013, 52,674 PSUs were issued to nine members of management as a reward for performance in 2012. The PSUs issued to management vest ratably over 12 consecutive quarters beginning January 1, 2013 and are



**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

accounted for as liability compensatory awards similar to the PSUs issued in December 2010 and January 2012. These PSUs will be remeasured each period and a liability will be recorded equal to GWRC's closing share price on the period end date multiplied by the number of units vested.

**Phantom stock appreciation rights compensation** – In January 2012, in an effort to reward employees for their performance in 2011 as well as to recognize performance since 2007, the last year the Company paid bonuses, we adopted a phantom stock appreciation rights plan (the “PSAR Plan”) authorizing the directors of the Company to issue phantom stock appreciation rights (“PSARs”) to our employees. The value of the PSARs issued under the plan track the performance of GWRC's shares. Each holder of the January 2012 award has the right to receive a cash payment amounting to the difference between C\$4.00 per share (the “exercise price”) and the closing price of GWRC's common shares on the exercise date, provided that the closing price is in excess of C\$4.00 per share. In total, 152,091 PSARs were issued to employees below the senior management level, and 122,097 remained outstanding as of December 31, 2012. The PSARs vested in equal installments over the four quarters of 2012 and will expire four years after the date of issuance. Holders of PSARs may exercise their awards once they have vested. Individuals who voluntarily or involuntarily leave the Company forfeit their rights under the awards.

PSARs are accounted for as liability compensatory awards under ASC 710, *Compensation – General*, rather than as equity awards. The PSAR awards will be remeasured each period based on GWRC's share price relative to the C\$4.00 per share exercise price. To the extent that GWRC's share price exceeds C\$4.00 per share, a liability will be recorded in the Company's financial statements representing the present value of the benefits expected to be provided to the employee upon exercise.

## **11. SUPPLEMENTAL CASH FLOW INFORMATION**

The following is supplemental cash flow information for the years ended December 31, 2012 and 2011 (in thousands of US\$):

	<b>2012</b>	<b>2011</b>
Cash paid for interest .....	\$ 8,360	\$ 7,960
Capital expenditures included in accounts payable and accrued liabilities .....	1,236	503

## **12. COMMITMENTS AND CONTINGENCIES**

**Commitments** – We lease certain office space in Arizona under operating leases with terms that expires in February 2016. Rent expense arising from the operating leases totaled approximately \$567,000 and \$483,000 for the years ended December 31, 2012 and 2011, respectively. We also lease the land on which one of our owned regional offices is located on a year-to-year basis. Rent expense associated with this land lease totaled approximately \$7,800 and \$7,600 for the years ended December 31, 2012 and 2011.

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The office lease agreements have escalating payment schedules. At December 31, 2012, future minimum rental payments for our corporate office leases for the years ending December 31 are as follows (in thousands of US\$):

2013 .....	\$ 588
2014 .....	606
2015 .....	584
2016 .....	98
Total .....	<u>\$ 1,876</u>

See also our commitment to provide services to GWRC in Note 6.

**Contingencies – Infrastructure Coordination and Financing Agreements (ICFAs)** – ICFAs are voluntary, alternative financing mechanisms the Company periodically employs, which allow developers and homebuilders to defer financial participation in the up-front investment in infrastructure and relegates their involvement to certain future payment obligations. The Company generally takes a security interest in the developer’s real property when the ICFAs are recorded against the land. Under the ICFA, payment is made upon the occurrence of certain regulatory or development milestones, or at the conclusion of the entitlement process. The largest of these fees are collectable from the developers typically as their land is sold to homebuilders, which is typically concurrent with the receipt of final plat approval and the time the land is converted from agriculture to residential use. The ICFA allows us, through our regulated subsidiaries, to plan and construct regional infrastructure for water, wastewater, and recycled water that ensures the maximum conservation and reuse. Further, the ICFA offers the opportunity for us to capture the maximum economies of scale through regional infrastructure planning and construction with a wide range of timing needs among various land developers. As discussed in Note 1, ICFA funds received are accounted for as contributions in aid of construction as a result of the 2010 Regulatory Rate Decision.

During the year ended December 30, 2011, the ACC approved the performance of an audit of the Company’s ICFA funds and policies. The Company views the ACC’s approval to conduct the audit as a favorable sign that the ACC is willing to consider ICFA fees as a reasonable source of financing for specified purposes, and to not automatically consider ICFA funds received as a reduction to the Company’s rate base used in ratemaking. The audit, which was performed by an independent third party auditor, focused on determining the amounts of acquisition premiums paid for the Company’s past acquisitions, as well as the sources and uses of ICFA funds. Although the Company cannot predict with certainty, we believe there to be a reasonable probability that the ACC will allow ICFA funds be used, at a minimum, for acquisitions; and that the Company’s rate base will not be adversely impacted by funds received under ICFA agreements provided those funds were used for acquisitions. To this end, the Company is continuing to work with the ACC staff.

**Contingencies – Legal Matters** – On December 28, 2005, Santa Cruz and Palo Verde filed Certificate of Convenience and Necessity (“CC&N”) applications based on requests for service for land within Maricopa and Casa Grande planning areas. On March 29, 2006, Arizona Water Company (“Arizona Water”) filed an application for virtually the same areas and filed a complaint against the Company. Arizona Water’s allegations in the complaint included, among other things, that: (1) the Company is illegally and improperly acting as a public service company; and (2) that the ICFAs and public-private-partnerships (“P3s”) are in violation of ACC practice and policy and Arizona law. Monetary damages were not been specified and are typically not awarded by the ACC.

GWRI and Arizona Water subsequently entered into a settlement agreement to apportion territory between the two parties, which was docketed with the ACC on May 16, 2008. The ACC conducted a hearing regarding the settlement agreement in June 2009, and briefs were submitted in August 2009. The staff Recommended Opinion and Order for this case was issued by the ACC on December 22, 2010.

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

On May 1, 2012, the ACC issued its decision on this matter. While the ACC did not specifically adopt or approve the settlement agreement, the decision noted that Arizona Water and GWRI were free to implement the terms of the settlement agreement among themselves. The ACC approved the extension of the CC&Ns for Santa Cruz and Palo Verde to properties that had previously submitted requests for service. Some additional properties that had not submitted request for service were added to the CC&Ns to create logical boundaries. The decision will be effective when Santa Cruz and Palo Verde file legal descriptions of the approved CC&N expansion for staff approval.

On May 31, 2012, Arizona Water and the Company filed a joint motion to dismiss Arizona Water's complaint without prejudice. On June 7, 2012, staff of the ACC filed a response stating that it does not oppose the motion to dismiss, and on July 19, 2012, the ACC approved the motion to dismiss.

The Company considers the Arizona Water matter to be resolved.

*Global Water Resources, Inc v. Sierra Negra Ranch, LLC and New World Properties, Inc (American Arbitration Association Case No. 76 198 Y 0010411 & 76 198 Y 0010511 respectively):* GWRI filed a claim against Sierra Negra Ranch, LLC ("SNR") and New World Properties, Inc ("NWP") for breach of the Infrastructure Coordination and Financing Agreements ("Agreements") for their respective developments. As the Agreements require binding arbitration for any dispute arising out of or relating in any way to the Agreements, we initiated a Demand for Arbitration and Statement of Claim against SNR and NWP (collectively the "Respondents") in May 2011 in response to the non-payment of certain fees due from Respondents to GWRI for major permitting milestones achieved. SNR and NWP did not dispute that we achieved the permit milestones that trigger payment. The monies we contended GWRI was owed pursuant to the Agreements from the Respondents was in excess of \$3,700,000 in principal (not including interest and recovery of litigation costs which we pursued during arbitration). Including interest and litigation costs, GWRI sought in excess of \$6 million. In response, SNR and NWP filed counterclaims for amongst other things, breach of contract and recession. The arbitration hearing concluded on March 2, 2012 and the interim award was received on March 28, 2012 indicating GWRI as the prevailing party in the arbitration. The final award was received April 20, 2012. According to the award, the arbitration panel found in the Company's favor on almost all claims, and ruled that the Company is entitled to approximately \$4.2 million of ICFA fees, 15% per annum interest totaling \$2.1 million and recovery of 1/3 of the legal costs incurred in connection with the litigation. In August 2012, we received the monies due from NWP totaling \$2,044,000, consisting of \$1,219,000 of past due ICFA fees, \$719,000 of interest and \$106,000 of reimbursed litigation costs. With respect to the \$719,000 of interest received from NWP, the Company has recorded the amount within *other income (expense)* in our statements of operations for the year ended December 31, 2012. The Company acknowledges that uncertainly exists as to whether the ACC would require an alternative accounting treatment. While it is reasonably possible that the ACC will seek to give the amount of interest to rate payers, such as in the form of reduced rates, we do not believe such a decision from the ACC is probable. Regarding the amount due from SNR, we note that the developer filed for bankruptcy in August 2012, which has resulted in a delay in receiving the award payment. Nevertheless, we are actively pursuing all available means to collect the award from SNR, including potentially selling the judgment.

We are involved in other proceedings arising in the ordinary course of business. Management believes the ultimate resolution of such matters will not materially affect our financial position, results of operations, or cash flows.

### **13. LIQUIDITY AND CAPITAL RESOURCES**

The Company's capital resources are provided by internally generated cash flows from operations as well as debt and equity financing. Additionally, GWRI's regulated utility subsidiaries receive advances and contributions from customers, home builders and real estate developers to partially fund construction necessary to extend service to new areas. GWRI uses its capital resources to (i) fund operating costs, (ii) fund capital requirements, including

**GLOBAL WATER RESOURCES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

construction expenditures, (iii) make debt and interest payments, and (iv) invest in new and existing ventures. GWRI's utility subsidiaries operate in rate-regulated environments in which the amount of new investment recovery may be limited, and where such recovery takes place over an extended period of time, as recovery through rate increases is subject to regulatory lag. As a result of these factors, GWRI's working capital, defined as current assets less current liabilities, as of December 31, 2012, is in a net deficit position.

As of December 31, 2012, GWRI had significant notable near-term cash expenditure obligations. Most significantly, the Company has approximately \$4.1 million of debt interest payments due June 2013 and approximately \$7.1 million of debt interest and principal payments due December 2013. While specific facts and circumstances could change, we believe we will be able to generate sufficient cash flows to meet our required debt service and operating cash flow requirements as well as remain in compliance with our debt covenants for at least the next twelve months. However, we have had recurring net losses and if our future operating performance is below our expectations, our liquidity and ability to operate our business could be adversely impacted.

**14. SUBSEQUENT EVENTS**

Subsequent events have been evaluated up to and including March 28, 2013, which is the date these financial statements were approved by GWRI's board of directors.

\* \* \* \* \*

## Board of Directors

**William S. Levine**  
Chairman of the Board  
Phoenix, Arizona, USA

**Trevor T. Hill**  
President & Chief  
Executive Officer  
Phoenix, Arizona, USA

**David C. Tedesco**  
Independent Director  
Scottsdale, Arizona, USA

**Richard M. Alexander**  
Independent Director  
Calgary, Alberta, Canada

**L. Rita Theil**  
Independent Director  
Aurora, Ontario, Canada

## Executive Officers

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President & Chief  
Executive Officer

**Cindy M. Liles**  
Executive Vice President &  
Chief Financial Officer

**Graham S. Symmonds**  
Senior Vice President &  
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**Jason C. Bethke**  
President, FATHOM™

**Ron Fleming**  
President, Regulated  
Utilities Division

**Brett Higginbotham**  
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**John Peckardt**  
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Stock symbol: GWR

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