



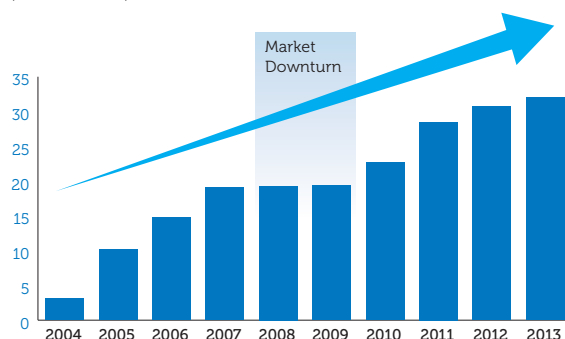
**GLOBAL WATER**

2013 Annual Report

## Revenue Growth

**29.8%**  
CAGR

Regulated Revenue  
(millions USD)



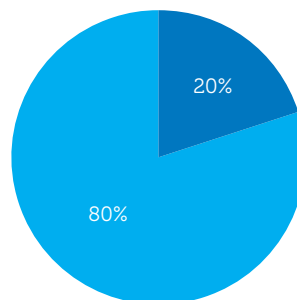
## High Market Share Drives Growth

**~20%**

of all available lots in Metro Phoenix Area  
are in Global Water's service territory

Available Lots

■ Global Water ■ Others



## 2014 New Customer Rates Approved

**\$4.6M**

of additional annualized revenue  
based on 2013 connections

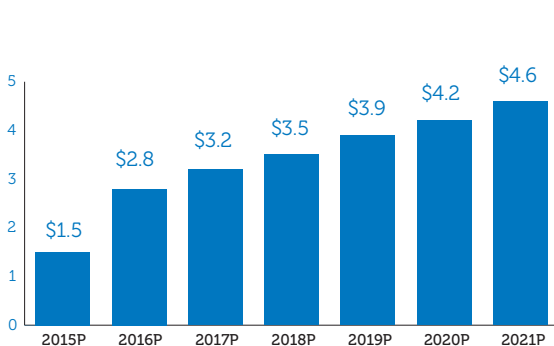
**14.3%**

increase over 2013 revenue

**>\$60M**

increase in Balance Sheet equity and ratebase-able  
assets from reversal of 2010 Regulatory Provision  
(expected in Q1-2014)

Phased In Revenue Increase  
(millions USD)



## Customer Connection Growth

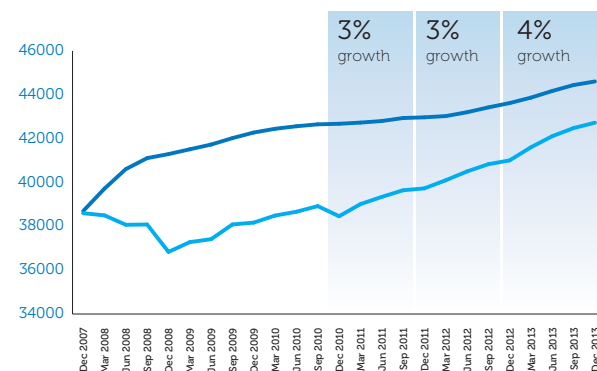
**42,726**

active service connections  
December 2013

**4.2%**

annual organic growth in active  
connections for 2013

■ Total Service Connections ■ Active Service Connections



# Fellow Shareholders,

Global Water was established to provide our industry with a Total Water Management solution and to provide shareholders with a stable growth investment. As a scarce resource, we knew water should be actively managed throughout its entire cycle, thereby maximizing its environmental and economic value. We accomplished that with both FATHOM™ and the Global Water regulated utility business division.

Nonetheless, as the financial market craved yield investments, eighteen months ago management recommended to the board that we divest of FATHOM and put Global Water on a path to surface near term value for our shareholders. Our publicly-traded water utility peers all pay a healthy dividend. Utilities are regulated and generate highly predictable and sustainable cash flows and enjoy high multiples and excellent capitalization rates from the dividends they pay. In fact the sector trades at an average capitalization rate on a dividend of less than three percent. Global Water has higher growth, higher margin and on initialization, higher dividend than our regulated peers. This combination provides near term promise in surfacing the hidden value in Global Water and returning the stock price to its historic highs and beyond.

Global Water has a very high revenue growth rate compared to our peers and we can grow our connection base substantially without the requirement of material capital expenditure, making our holdings unique in the sector. We believe that by focusing the Company on our core regulated utilities, Global Water can achieve similar or better results compared to our peers.

I believe that a simplified story will allow the very significant value within Global Water to emerge. We divested of FATHOM and successfully completed our rate case, including the reinstatement of more than \$60 million of regulatory assets to our balance sheet. These actions improved our retained earnings and equity position sufficiently to allow for the initiation of a dividend. Our cash flows are strong and our capital requirements are minimal, allowing our dividend to be stronger than our peers at its launch. In addition to this strategy we set about to sell off non-core assets and collect on long-standing litigation proceeds due to us. Incremental to our success on the recent rate case, these actions generated more than \$10 million in cash for the Company, putting us in a strong cash position further supporting the initiation of a dividend.

The market has responded positively to the plan that we have executed over the past eighteen months and a great deal of shareholder value has been recovered. On March 26, 2014, we announced the commencement of our dividend at CAD\$0.264 per share annualized, the final benchmark that will allow investors and analysts to compare and contrast Global Water to its peers. When they do, they will find that we compare favorably in growth, free cash flow, margin, capital expenditures and dividend.

We see a continuously improving outlook as a result of the newly approved customer rates generating seven years of rate increases, as well as:

- the return of growth to the Phoenix area,
- the limited number of areas where new homes can be built, and
- Global Water's disproportionately large share of the finished lots within these areas.

Global Water is now well-positioned to deliver on the promise made to shareholders at the IPO. I am extremely proud of the team we assembled to execute the mission I described above. Without their professionalism, enthusiasm and belief in our cause, the story may have been different.

I also appreciate the patience of our shareholders. Your faith and belief in me and the team is recognized and we will continue to surface the value that we all believe exists in Global Water.

Many thanks,

A handwritten signature in dark ink, appearing to read 'T. Hill', with a stylized, cursive flourish.

**Trevor T. Hill**

Chairman of the Board of Directors

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 25, 2014

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, 2013. 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, 2013 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. Bowers  
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 25, 2014 relates to the years ended December 31, 2013 and 2012 and should be read together with our audited financial statements and related notes as of and for the years ended December 31, 2013 and 2012. Investors should also refer to the 2013 audited 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 include expectations of earnings growth described in "Outlook". 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 had an unregulated business, whose services were 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 third party services to municipalities and private utilities. On June 5, 2013, GWRI sold a majority interest in the FATHOM™ business. Please see the accompanying management’s discussion and analysis of GWRI for more details regarding the sale of the FATHOM™ business.

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%.

**Outlook** – Whereas the Company accounts for its investment in GWRI using the equity method of accounting, the carrying value of the investment is adjusted each period to include GWRC’s proportionate share of the earnings or losses of the investee. Since the date of the Offering through December 31, 2013, GWRC has recorded significant



equity investment losses as a result of losses generated by GWRI. However, in February 2014, GWRI completed the regulatory rate case which was initiated by GWRI's utility companies in 2011. The regulatory rate case will provide, among other things, additional revenues to GWRI which will be phase-in over time. The Company and GWRI are currently evaluating the impact of the rate case decision, including whether sufficient evidence exists that GWRI's net deferred tax assets will be utilized in the future; thus allowing the reversal of the valuation allowance currently recorded. With the exception of the phase-in of new rates to be charged to GWRI's utility customers, we expect that the impact of the rate decision will be effective for GWRI in the first quarter of 2014. We anticipate that the impact of the rate decision, combined with the anticipated effect of reversing the valuation allowance, will result in approximately \$60 million of additional income in GWRI's financial statements to be reported in the three months ended March 31, 2014. Assuming GWRC will pick-up approximately \$28.9 million (\$60 million multiplied by GWRC's 48.1% interest) of equity method earnings as a result of GWRI's gain, we expect that the carrying value of GWRC's investment in GWRI will increase significantly during the three months ended March 31, 2014. Please see the accompanying discussion and analysis of GWRI for more details regarding the completion of the regulatory rate case.

We are currently evaluating the impact of this potentially significant increase to the carrying value of the Company's investment. However, to the extent that the carrying value of the investment exceeds its fair value, a partial impairment of the investment may be recorded.

**Results of operations for the years ended December 31, 2013 and 2012** –The following table summarizes GWRC's results of operations for the years ended December 31, 2013 and 2012 (in thousands of US\$, except per share amounts).

	<b>For the Years Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Loss from equity investment .....	\$ (3,628)	\$ (18,694)
Operating expenses .....	320	397
Operating loss .....	(3,948)	(19,091)
Loss before income taxes .....	(3,948)	(19,091)
Income tax benefit .....	-	-
Net loss .....	<u>\$ (3,948)</u>	<u>\$ (19,091)</u>
Loss per share .....	<u>\$ (0.45)</u>	<u>\$ (2.18)</u>
Loss per share, excluding the gain on the sale of GWRI contracts, loss on sale of FATHOM <sup>TM</sup> and the effect of GWRI's valuation allowance .....	\$ (0.53)	\$ (0.33)

To date, the Company has not declared any dividends.

**Loss from Equity Investment** – Loss from equity investment for the years ended December 31, 2013 and 2012 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, 2013 and 2012, multiplied by GWRC's 48.1% equity method interest in GWRI. 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, 2013). 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, 2013 and 2012 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 \$3,948,000 and \$19,091,000 for the years ended December 31, 2013 and 2012, respectively, was determined by deducting operating expenses from loss from equity investment. The loss on equity investment was particularly impacted during the year ended December 31, 2013 as a result of (i) a \$3.3 million gain recorded by GWRI upon selling certain contracts, and (ii) the \$1.9 million loss recorded by GWRI related to the sale of GWRI’s FATHOM™ business. Excluding the impact of the gain on the contracts sale and the loss on the sale of the FATHOM™ business, the Company’s loss totaled \$4,600,000, or \$(0.53) per share, for the year ended December 31, 2013.

Additionally, the decreased loss on equity investment for the year ended December 31, 2013 was primarily a result of a valuation allowance recorded against GWRI’s net deferred tax assets during the second quarter of 2012, while no such expense was recorded during 2013. 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, 2013 (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.

	2013				2012			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
LOSS FROM EQUITY INVESTMENT .....	\$ 66	\$ 318	\$ (2,399)	\$ (1,613)	\$ (874)	\$ (321)	\$ (16,448)	\$ (1,051)
OPERATING EXPENSES .....	59	113	17	131	64	53	156	124
OPERATING INCOME (LOSS) .....	7	205	(2,416)	(1,744)	(938)	(374)	(16,604)	(1,175)
INCOME (LOSS) BEFORE INCOME TAXES .....	7	205	(2,416)	(1,744)	(938)	(374)	(16,604)	(1,175)
INCOME TAX BENEFIT .....	-	-	-	-	-	-	-	-
NET INCOME (LOSS) .....	\$ 7	\$ 205	\$ (2,416)	\$ (1,744)	\$ (938)	\$ (374)	\$ (16,604)	\$ (1,175)
INCOME (LOSS) PER SHARE .....	\$ 0.00	\$ 0.03	\$ (0.28)	\$ (0.20)	\$ (0.11)	\$ (0.04)	\$ (1.90)	\$ (0.13)
LOSS PER SHARE, EXCLUDING GAIN ON SALE OF GWRI CONTRACTS, LOSS ON SALE OF FATHOM™ AND THE EFFECT OF GWRI'S INCOME TAX VALUATION ALLOWANCE .....	\$ (0.07)	\$ (0.09)	\$ (0.17)	\$ (0.20)	\$ (0.07)	\$ (0.03)	\$ (0.10)	\$ (0.13)

## **Outstanding Share Data**

As of March 25, 2014, there were 8,754,612 common shares of the Company outstanding and options to acquire an additional 278,511 common shares of GWRC. The number of options decreased during 2013 due to forfeiture by former employees. Please see the description below in “Related Party Transactions”.

## **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, 2013 or 2012. GWRI has funded the Company’s operating expenses incurred through December 31, 2013. See Notes 3 and 6 to GWRC’s financial statements for the year ended December 31, 2013.

## **Insurance Coverage**

As we do not carry on any active business operation, the Company does not carry insurance coverage other than a \$15,000,000 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, 2013.

## **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 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 remeasured the fair value of the award at the end of each period until the options became fully vested on December 31, 2013.

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 \$25,000 and \$51,000 for the years ended December 31, 2013 and 2012, respectively, 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.

In addition to the amount above, due to attrition and the sale of FATHOM™, certain former employees of GWRI forfeited their stock options during the year ended December 31, 2013. The number of stock options forfeited totaled 107,186. As a result of the forfeitures, approximately \$23,000 of previously recorded stock-based compensation was reversed during the period.

### **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, 2013. 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, 2013.

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

### *Evaluation of Disclosure Controls and Procedures*

Our Chief Executive Officer and Chief Financial Officer have 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, 2013, and has concluded that such internal control over financial reporting is effective as of December 31, 2013. 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).

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**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 25, 2014 relates to the years ended December 31, 2013 and 2012 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 include future estimates described in "Unregulated Division", "Infrastructure Investment", and "Recent Rate Case Activity", and expectations of future liquidity in "Liquidity and Capital Resources", and of future market risk in "Quantitative and Qualitative Disclosure about Market Risk". 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 Chairman and Chief Executive Officer Trevor T. Hill and investor and Boardmember, 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. Until the sale of GWM (defined below), GWRI's business had been comprised of 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 historically operated an Unregulated business, whose services were marketed by GWRI's subsidiary Global Water Management, LLC ("GWM") as FATHOM<sup>TM</sup>. FATHOM<sup>TM</sup> offers an integrated suite of cloud-based geo-spatial advanced technology-enabled platforms to provide 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 GWM's municipal and private utility clients. On June 5, 2013, GWRI sold GWM and now owns a minority interest in the FATHOM<sup>TM</sup> business. See further discussion regarding the sale of GWM below.

The Company had 65 employees at December 31, 2013 compared to 143 employees at December 31, 2012. The reduction in headcount primarily resulted from the sale of GWM.

Our Regulated division provides drinking water, wastewater and other water related services to approximately 68,000 people in Arizona as of December 31, 2013. 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 and environmental 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.

Through December 31, 2013, we continued to execute on our strategy to optimize and focus the Company in order to provide greater value to our customers and shareholders by aiming to deliver predictable financial results, making prudent capital investments and focusing our efforts on earning an appropriate rate of return on our investments.

## **UNREGULATED DIVISION**

### ***Background and Divestiture of FATHOM™ business***

The Company developed and operated its FATHOM™ business to provide utility customer support and billing services, and automated metering infrastructure and asset management solutions to municipal and private utility clients, as well as to the Company’s own regulated utilities. The Company began commercializing FATHOM™ in 2009 and since then the business experienced significant growth, both from the perspective of revenue generated for the Company, and the number of customer accounts being serviced.

The FATHOM™ platform not only provided clients with the opportunity for increased revenue and decreased costs, it also provided for customer facing tools, not only to improve the customer’s ability to manage and pay their bills, but also providing them useful information about their own water consumption. Our prior investment in the FATHOM™ platform provided for more automation in business processes and more analytical capabilities, improving customer service metrics and lowering costs of operations.

However, despite the significant market interest in FATHOM™, the adoption through contracting was often a lengthy process which was difficult to reliably predict. Formal contracting of new clients for FATHOM™ was below expectations and required significant amounts of capital to fund investments, operations and business development efforts. Much of this capital required by FATHOM™ was effectively funded by resources generated from our Regulated utilities business. Notwithstanding our continued belief in the FATHOM™ business and its long-term growth opportunities, we believed that it was in the best interests of GWRI’s core Regulated Utilities business, as well as of the FATHOM™ business, that FATHOM™ be owned, financed, managed and operated separately from GWRI. Accordingly, during the second quarter of 2013, GWRI made the decision to divest itself of GWM, the former GWRI subsidiary that directly owns the FATHOM™ business.

On June 5, 2013, the Company sold GWM to an investor group led by a private equity firm that specializes in the water industry. The transaction was effected through the sale of all of the outstanding membership interests of GWM to a wholly-owned subsidiary of Fathom Water Management Holdings, LLP (the “Fathom Partnership”). The Company received the following consideration for the sale of GWM: (a) a cash payment of \$4.25 million (subject to a post-closing working capital adjustment resulting in a \$1.7 million liability for the Company, which the Company has paid as of December 31, 2013); and (b) the issuance to the Company of common and preferred units of the

Fathom Partnership with a deemed initial value of \$0.8 million. In addition, the Company is entitled to quarterly royalty payments based on a percentage of certain of GWM's recurring revenues for a 10-year period, up to a maximum of \$15.0 million.

Concurrent with the closing, \$750,000 of the cash portion of the purchase price was reinvested by the Company in a promissory note issued by GWM's parent. The promissory note is due December 31, 2014, bears interest at a rate of 10% per annum and is convertible into equity of the Fathom Partnership. The convertible note will be converted upon a qualified financing of FATHOM™ Partnership or at the discretion of the majority partner of FATHOM™ Partnership, but no later than the date of maturity (qualified financing has been defined as an equity financing by FATHOM™ Partnership in which FATHOM™ Partnership sells its units for at least \$1.75 per unit and the aggregate proceeds from such financing is at least \$15 million, exclusive of convertible note amounts converted).

The Company will continue to hold an indirect interest in GWM through its ownership of the common and preferred units of the Fathom Partnership received in consideration for the sale of GWM. Together, these units represent an approximate 12.7% ownership interest in the Fathom Partnership (on a fully diluted basis) at December 31, 2013.

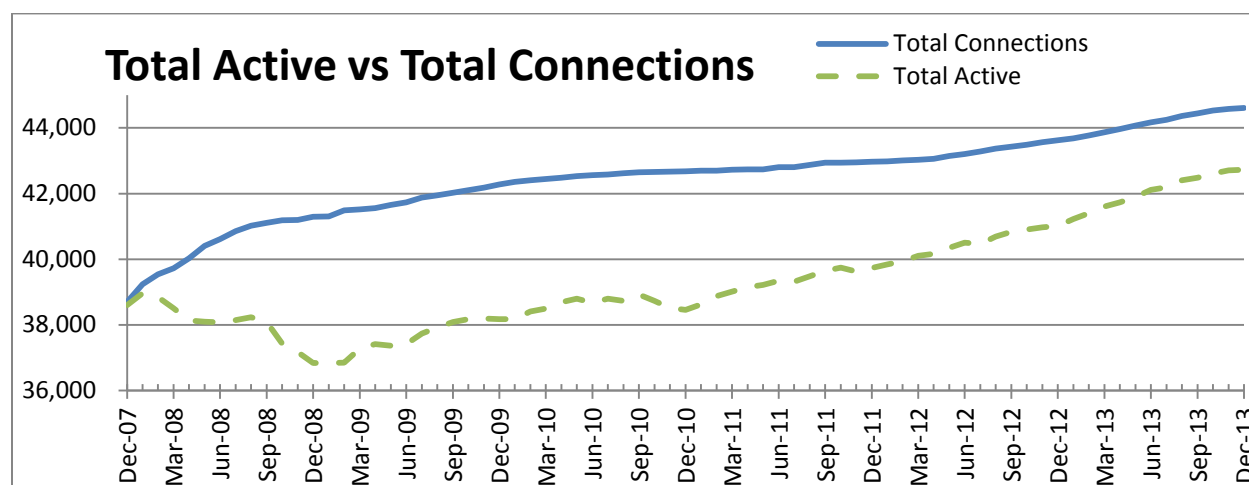
GWM has historically provided billing, customer service and other support services to the Company. The Company has entered into a services agreement with GWM whereby the Company has agreed to use the FATHOM™ platform for all of its regulated utility services for an initial term of 10 years. The services agreement is automatically renewable thereafter for successive 10-year periods, unless notice of termination is given prior to any renewal period. The services agreement may be terminated by either party for default only and the termination of the services agreement will also result in the termination of the royalty payments payable to the Company. The sale of GWM has resulted in changes to the recurring costs to be recorded by the Company. Based on current connections, we estimate that costs to be paid to GWM for FATHOM™ services will be \$7.69 per water account/month, an annual rate of approximately \$2.4 million.

## 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 the Company's 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 44,608 as of December 31, 2013 from 43,623 as of December 31, 2012. GWRI's active service connections increased to 42,726 as of December 31, 2013 compared to 41,008 as of December 31, 2012, representing an annual increase of 4.2%.



**Regulated Business Outlook** – 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, approximately 11.2% of our total connections at the time; however, the negative trend began to reverse thereafter.

The 2013 fiscal year continued the trend of positive growth in new connections as well as re-establishing service on existing previously vacant homes. 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. Forbes forecasted a 2.7% population growth rate during 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. As noted per the Arizona State University W.P. Carey School of Business Job Growth Update, employment for the Phoenix Metropolitan area increased by 42,200, or 2.76%, over the twelve months ending August 31, 2013. This growth ranks ninth amongst the largest U.S. cities.

Also, according to the W.P. Carey School of Business Greater Phoenix Blue Chip Real Estate Consensus panel, most sectors of real estate are 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 11,615 units in 2012 and is expected to have ended 2013 with 13,483 units. The same consensus forecast projects 19,285 units in 2014, and 23,758 units in 2015. Growth in the region is expected to steadily return to its steady-state rate of greater than 30,000 Single Family Dwelling permits by 2016-2017. Additionally, multifamily, office, retail, and industrial

market vacancy rates are expected to decline for the years ending 2013 and 2014. Phoenix was one of the worst performing housing markets during the housing downturn, but prices have risen 16.7% over the last twelve months ending November 30, 2013 according to the S&P/Case-Shiller Phoenix Home Price Index.

GWRI's acquired utilities and monopolistic service territories are directly in the anticipated path of growth primarily in the metropolitan Phoenix area. Market data indicates 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.

In another initiative to focus the company on its existing core assets and service territories, in September 2013, the Company sold and transferred all agreements pertaining to the Loop 303 Project (defined below) and GWRI's subsidiary Global Water – 303 Utilities Company, Inc. ("303 Utilities Company") along with their related rights and obligations to a third party (the "Sale of 303 Contracts"). The Loop 303 Project consisted of providing water utility coordination, permitting, and engineering design work for certain developers/landowners within the City of Glendale, Arizona. Pursuant to the Sale of 303 Contracts, GWRI will receive total proceeds of approximately \$4.1 million over a multi-year period. As part of the consideration, GWRI agreed to complete certain engineering work required in the agreements, which work was completed by the end of 2013. Since this engineering work has been completed, the Company effectively has no further obligations under the Loop 303 Project or any of the agreements. Through December 31, 2013, the Company has received \$2.8 million of proceeds and has recognized income of approximately \$3.3 million within other income (expense) in the statement of operations for the period ended December 31, 2013. In addition to cash proceeds received, the amount of income recorded reflects the extinguishment of certain net liabilities related to the Loop 303 Project. Receipt of the remaining \$1.3 million of proceeds will occur and be recorded as additional income over time as certain milestones are met between the third party acquirer and the developers/landowners.

### ***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 a historical test year to evaluate whether the plant in service is used and useful, to assess whether costs were prudently incurred and to set "just and reasonable" rates. Rate base is 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. GWRI's wastewater utility services are billed based solely



on a fixed fee, determined by the size of the water meter installed. Recycled water is sold on a volumetric basis with no fixed fee component.

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. As a result, there is frequently a delay, or regulatory lag, between the time of a capital investment or incurrence of an operating expense increase and when those costs are reflected in rates. 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 routinely updates a rate model that reviews changes in current connection growth and expense structure combined with capital invested to determine the appropriate 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 rate applications with the ACC to adjust the revenue requirements for seven utilities representing a collective rate increase of approximately 28% over 2011's revenue. In August 2013, the Company entered into a settlement agreement with ACC Staff, the Residential Utility Consumers Office, the City of Maricopa, and other the parties to the rate case. The settlement required approval by the ACC's Commissioners before it will take effect. In February 2014, the rate case proceedings were completed and the ACC issued Rate Decision No. 74364, effectively approving the settlement agreement. The rulings of the decision include, but are not limited to, the following:

- For the Company's utilities, a collective revenue requirement increase of \$4.3 million *based on 2011 test year connections*, phased-in over time, with the first increase in January 2015 as follows (in thousands of US\$):

	<b>Incremental</b>	<b>Cumulative</b>
2015 .....	\$ 1,416	\$ 1,416
2016 .....	1,219	2,635
2017 .....	335	2,970
2018 .....	336	3,306
2019 .....	335	3,641
2020 .....	335	3,976
2021 .....	335	4,311

- Full reversal of the imputation of Contributions in Aid of Construction ("CIAC") associated with funds previously received under Infrastructure Coordination and Financing Agreements ("ICFA"), as required in the Company's last rate case. The effectively reversal restores approximately \$60 million in rate base or future rate base.
- The Company has agreed to not enter into any new ICFA agreements. Existing ICFAs will remain in place, but a portion (approximately 70%) of future payments to be received under the ICFAs will be considered as hook-up fees, which are accounted for as CIAC once expended on plant (i.e., hook-up fees will be recorded as a liability, but will only reduce rate base on once such funds are expended on plant). The remaining approximate 30% of future ICFA payments will be subject to the similar income recognition accounting as applied to ICFA funds already received, which is that such funds will be recorded as revenue or deferred revenue.
- A 9.5% return on common equity is adopted for rate making.
- None of the Company's utilities will file another rate application before May 31, 2016. GWRI's subsidiaries, Santa Cruz Water Company and Palo Verde Utilities Company may not file for another rate increase before May 31, 2017.

Rate Decision No. 74364 is a public document and is posted on the Company's website and at the ACC's eDocket website, <http://edocket.azcc.gov> under the docket number 12-0309.

The Company is currently evaluating the impact of Rate Decision No. 74364. With the exception of the phase-in of new rates to be charged to our utility customers, we expect that the impact of Rate Decision No. 74364 will be effective for the Company in the first quarter of 2014. Other than the phase-in of increased rates, GWRI expects the decision to result in an immediate impact to certain balances. Although the impact of Rate Decision No. 74364 is not retroactive to fiscal year 2013, the following table summarizes management's expectation for the impact of the decision on GWRI's balance sheet, assuming the impact was recorded as of December 31, 2013 (in thousands of US\$):

	<b>December 31, 2013 (as Reported)</b>	<b>Adjustments resulting from rate case</b>	<b>December 31, 2013 (pro forma)</b>
<b>ASSETS:</b>			
Net property, plant and equipment.....	\$ 249,010	\$ -	\$ 249,010
Cash and cash equivalents.....	1,960	-	1,960
Other current assets.....	5,050	-	5,050
Total current assets.....	7,010	-	7,010
Intangible assets - net <sup>(1)</sup> .....	1,545	3,368	4,913
Other noncurrent assets <sup>(2)</sup> .....	29,145	11,221	40,366
Total other assets.....	30,690	14,589	45,279
Total Assets.....	<u>\$ 286,710</u>	<u>\$ 14,589</u>	<u>\$ 301,299</u>
<b>LIABILITIES:</b>			
Current liabilities.....	\$ 12,338	\$ -	\$ 12,338
Long-term debt.....	128,738	-	128,738
Deferred gain – noncurrent <sup>(3)</sup> .....	-	16,676	16,676
Advances in aid of construction.....	97,253	-	97,253
Contributions in aid of construction - net <sup>(4)</sup> .....	74,774	(64,089)	10,685
Other noncurrent liabilities.....	6,449	-	6,449
Noncurrent liabilities.....	307,214	(47,413)	259,801
Total Liabilities.....	319,552	(47,413)	272,139
SHAREHOLDERS' EQUITY (DEFICIT) <sup>(5)</sup> .....	(32,842)	62,002	29,560
Total Liabilities and Shareholders' Equity (Deficit).....	<u>\$ 286,710</u>	<u>\$ 14,589</u>	<u>\$ 301,299</u>

(1) In connection with the 2010 Regulatory Rate Decision, a regulatory liability was established as an offset against the Company's ICFA-related intangible assets, effectively reducing the economic carrying value of those intangible assets to \$0. The ICFA-related intangibles represent the future economic benefits to be received by the Company from certain ICFA contracts acquired. The \$3,368,000 amount represents the proportionate amount of the gross intangible asset balance relative to the portion of future ICFA funds to be received and recorded as revenue (\$3,368,000 represents approximately 30% of the Company's total ICFA-related intangible assets balance as of December 31, 2013).

(2) Effective June 30, 2012, a deferred income tax valuation allowance was established against the Company's net deferred tax assets. Until the valuation allowance is reversed, net income tax expense or benefit reported will be minimal and no deferred tax assets will be reflected in GWRI's balance sheet. However, as a result of Rate Decision No. 74364 we believe that sufficient evidence exists that the Company's net deferred tax assets will be utilized in the future, thus allowing for the potential reversal of the valuation allowance currently recorded. Among the Company's net deferred tax assets, the Company has approximately \$6.1 million after-tax net operating loss carryforwards available. See Note 9 of GWRI's 2013 consolidated financial statements.

(3) As a result of Rate Decision No. 74364, ICFA funds previously received which are currently recorded as CIAC will no longer be recorded as CIAC. Such ICFA amounts will be subjected to an evaluation as to whether the Company has met the

earnings process requirements necessary to recognize the amounts within income. We anticipate that approximately \$16.7 million of the ICFA funds received through December 31, 2013 relate to contracts for which the earnings process has not yet been fully accomplished.

- (4) See tickmark (3) above. This amount represents the ICFA funds recorded as CIAC as of December 31, 2013. As a result of Rate Decision No. 74364, ICFA funds previously received will no longer be recorded as CIAC; rather they will either be reclassified to a deferred gain account or flow through equity as a result of being recognized as income.
- (5) This amount represents the net impact to the Company's statement of operations from the adjustments discussed above. To a large degree, the amount represents the reversal of the accounting entries recorded in 2010 as a 2010 Regulatory Rate Decision.

### ***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 eight years and because the infrastructure is new, significant capital, either for growth or to maintain the existing infrastructure, is not expected to be required in the near term. GWRI estimates that capital expenditures of the Regulated business will total approximately \$2.5 million annually over the next few years. 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 resources and therefore 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 costs include labor, 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 most of GWRI's production costs have increased in recent years. However, GWRI employs a variety of technologies and methodologies to minimize costs and maximize operational efficiencies. For power alone, GWRI has been successful in offsetting the rise in power costs by vigilantly focusing on timing and duration of power requirements. Additionally, with GWRI's unique resources management approach, TWM, whereby we maximize the direct beneficial reuse 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 commonly occurring and regulated constituents such as arsenic, or for other current or future human consumption 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, 2013, 2012, and 2011 (in thousands of US\$):

	December 31, 2013	December 31, 2012	December 31, 2011
<b>ASSETS:</b>			
Net property, plant and equipment.....	\$ 249,010	\$ 260,236	\$ 265,948
Current assets .....	7,010	8,750	9,138
Other assets .....	30,690	30,411	55,536
Total Assets.....	<u>\$ 286,710</u>	<u>\$ 299,397</u>	<u>\$ 330,622</u>
<b>LIABILITIES:</b>			
Current liabilities .....	\$ 12,338	\$ 14,707	\$ 21,570
Noncurrent liabilities.....	307,214	311,254	296,690
Total Liabilities.....	319,552	325,961	318,260
SHAREHOLDERS' EQUITY (DEFICIT).....	(32,842)	(26,564)	12,362
Total Liabilities and Shareholders' Equity (Deficit).....	<u>\$ 286,710</u>	<u>\$ 299,397</u>	<u>\$ 330,622</u>

The following contains selected financial information of GWRI's results of operations for the years ended December 31, 2013, 2012 and 2011 (in thousands of US\$):

	Years Ended December 31,		
	2013	2012	2011
Revenues.....	\$ 33,434	\$ 33,538	\$ 36,405
Operating expenses.....	31,419	32,550	32,836
Operating income .....	2,015	988	3,569
Total other income (expense) .....	(8,039)	(8,802)	(8,849)
Loss before income taxes.....	(6,024)	(7,814)	(5,280)
Income tax (expense) benefit.....	(16)	(30,667)	1,972
Net loss .....	<u>\$ (6,040)</u>	<u>\$ (38,481)</u>	<u>\$ (3,308)</u>

## Comparison of Results of Operations for the Years Ended December 31, 2013 and 2012

**Revenues** – The following table summarizes GWRI’s revenues for the years ended December 31, 2013 and 2012 (in thousands of US\$):

	Years Ended December 31,	
	2013	2012
Water services .....	\$ 18,200	\$ 17,417
Wastewater and recycled water services .....	13,829	13,244
Unregulated revenues .....	1,405	2,877
Total revenues .....	<u>\$ 33,434</u>	<u>\$ 33,538</u>

Total revenues decreased \$0.1 million, or 0.3%, for the year ended December 31, 2013 compared with the year ended December 31, 2012, primarily due to the absence of FATHOM<sup>TM</sup> unregulated revenues post divestiture.

*Water Services* – Water services revenues increased \$783,000, or 4.5%, to \$18.2 million for the year ended December 31, 2013 compared with \$17.4 million for the year ended December 31, 2012, primarily reflecting the impact of growth in total active connections.

Active water connections increased 4.1% to 25,688 as of December 31, 2013 from 24,681 as of December 31, 2012. As a result of connection growth, water consumption increased to 3.1 billion gallons for the year ended December 31, 2013 from 2.8 billion gallons for the year ended December 31, 2012. Water services revenue based on consumption increased \$346,000, or 4.5%, to \$8.0 million for the year ended December 31, 2013 from \$7.6 million for the year ended December 31, 2012, generally reflecting the increase in total active connections. Variability between the rate of consumption revenue growth and the rate of connection growth is caused by various factors including precipitation levels, temperature, and the mix of customer type (e.g., residential, commercial, irrigation, etc.) whose normal consumption levels typically place them into tiers subjected to differing billing rates.

Water services revenue, excluding miscellaneous charges, associated with the basic service charge increased \$230,000, or 2.4%, to \$9.6 million for the year ended December 31, 2013 compared to \$9.4 million for the year ended December 31, 2012, reflecting growth in active connections.

*Wastewater and Recycled Water Services* - Wastewater and recycled water services revenues increased \$585,000, or 4.4%, to \$13.8 million for the year ended December 31, 2013 compared to \$13.2 million for the year ended December 31, 2012 primarily due to increased active wastewater connections and greater recycled water usage. Active wastewater connections increased 4.4% to 17,038 as of December 31, 2013 from 16,327 as of December 31, 2012.

Wastewater revenue, excluding miscellaneous charges, which is billed and recognized at a flat rate per connection, totaled \$13.2 million for the year ended December 31, 2013 compared to \$12.7 million for the year ended December 31, 2012. The 4.2% increase in revenue reflects the growth of active connections mentioned above.

Recycled water revenue, which is based on gallons delivered, totaled \$328,000 for the year ended December 31, 2013 compared to \$307,000 for the year ended December 31, 2012. The volume of recycled water delivered increased to 587 million gallons for the year ended December 31, 2013 from 539 million gallons for the year ended December 31, 2012.

*Unregulated Revenues* – Unregulated revenues totaled \$1.4 million in the year ended December 31, 2013 compared to \$2.9 million in the year ended December 31, 2012, representing a decrease of \$1.5 million. Historically, unregulated revenues primarily consisted of revenues generated from customers of GWRI’s FATHOM<sup>TM</sup> business.

Subsequent to the June 5, 2013 sale of GWM, unregulated revenues have been limited to engineering services and rental revenue, resulting in the decline compared to the prior year.

In 2012 we began performing engineering services for third parties which we recognize on a percentage of completion basis. Engineering service revenue totaled \$160,000 and \$86,000 during the years ended December 31, 2013 and December 31, 2012, respectively, which primarily related to the Loop 303 Water Project. With the divestiture of this project, GWRI does not expect to record any further professional engineering services revenue.

**Operating Expenses** – The following table summarizes GWRI’s operating expenses for the years ended December 31, 2013 and 2012 (in thousands of US\$):

	<b>Years Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Operations and maintenance .....	\$ 11,995	\$ 11,994
General and administrative .....	9,623	9,657
Depreciation .....	9,801	10,899
Total operating expenses .....	<u>\$ 31,419</u>	<u>\$ 32,550</u>

*Operations and Maintenance* – Operations and maintenance costs, consisting of personnel costs, production costs (primarily chemicals and purchased power), maintenance costs, property tax, and costs formerly associated with FATHOM™ operations, remained flat for the year ended December 31, 2013 compared to the year ended December 31, 2012.

Total personnel costs decreased \$312,000, or 7.7%, for the year ended December 31, 2013 as compared to the year ended December 31, 2012. The decrease is primarily attributed to a reduction in FATHOM™ related personnel costs since such activity is no longer recorded by the Company subsequent to the June 5, 2013 sale of GWM. This reduction is partially offset by slightly higher personnel costs of the now stand-alone regulated utilities business.

Also, as a result of the June 5, 2013 sale of GWM, the costs in several operating expense categories associated with the FATHOM™ business decreased. In total, the Company experienced a decrease of approximately \$1.2 million in operating expenses for the year ended December 31, 2013 compared to the same period in 2012 due to lower costs in expense categories such as contract labor, phone and communication expense, computer repairs and maintenance, bank fees, and postage.

By contrast, GWRI’s contract services increased for the year ended 2013 as compared to the same period in prior year. The increase is primarily driven by the sale of GWM on June 5, 2013. Historically, all FATHOM™ service fees charged by FATHOM™ to GWRI’s regulated utilities would eliminate upon consolidation. As a result of the sale, this service fee no longer eliminates; thus resulting in charges totaling \$1.3 million during the 2013 period.

Property taxes increased \$291,000, or 17.2%, during the year ended December 31, 2013 compared to the year ended December 31, 2012. Whereas property tax is based in part on revenues experienced at our utilities, the increase in property taxes can be attributed to the increase in revenues. Property tax expense for 2012 was based on the average revenues from 2008-2010. Property tax expense for 2013 is based on the average revenues from 2009-2011. The increase in property tax is therefore primarily attributed to customer growth and the increased rates being charged pursuant to the 2010 Regulatory Rate Decision.

*General and Administrative* – General and administrative costs include the day-to-day expenses of office operation; salaries and wages, legal and other professional fees, insurance and regulatory fees. These costs decreased \$34,000, or 0.4%, during the year ended December 31, 2013 compared to the year ended December 31, 2012.

Personnel cost increased \$294,000, or 6.3%, for the year ended December 31, 2013 compared to the year ended December 31, 2012. The increase was primarily attributed to the Company's Phantom Stock Unit ("PSU") deferred compensation program as a result of a rising stock price.

Regulatory expense increased \$388,000, or 180.5%, for the year ended December 31, 2013 compared to the year ended December 31, 2012 due to the expensing of certain rate case related legal and consultant costs. As part of the August 2013 settlement agreement, and ultimately ratified by Rate Decision No. 74364, we determined that a portion of the rate case costs incurred by the Company will not be recoverable through rates to be charged to customers in the future.

General and administrative costs for most other categories decreased for the year ended December 31, 2013 compared to the year ended December 31, 2012. These categories include professional fees, rent, promotion and marketing, bad debt, travel and entertainment, and investor relations costs. The decreases primarily related to the FATHOM<sup>TM</sup> business and were largely driven by the sale of GWM on June 5, 2013.

*Depreciation* – Depreciation expense decreased by \$1.1 million, or 10.1%, to \$9.8 million for the year ended December 31, 2013 compared to the year ended December 31, 2012. The decrease primarily reflects the impact of the reduction of FATHOM<sup>TM</sup> related assets from the Company's balance sheet pursuant to the sale of GWM.

**Other Income (Expense)** – Other income (expense) totaled \$8.0 million of net expense for the year ended December 31, 2013 compared to \$8.8 million of net expense for the same period in 2012. Other income (expense) primarily consists of interest expense. Interest expense decreased to \$8.9 million for the year ended December 31, 2013 from \$9.6 million in 2012, reflecting the Company's 2012 write-off of \$602,000 of debt issuance costs in connection with the extinguishment of the Levine Promissory Note, the \$7.0 million Regions Term Loan, and another previously contemplated bond refinancing. Other factors impacting the overall change in other income (expense) were: (i) a \$3.3 million gain recorded during 2013 on the Sale of 303 Contracts; (ii) a \$707,000 loss on equity method investment recognized in 2013 related to our investment in FATHOM<sup>TM</sup>; (iii) a \$1.9 million loss recognized in 2013 related to the sale of GWM; and (iv) \$719,000 of income recognized during 2012 in connection with the NWP arbitration decision.

**Income Tax Benefit (Expense)** – Effective June 30, 2012, a valuation allowance of \$32.7 million was established against the Company's net deferred tax assets. Income tax expense recorded in the year ended December 31, 2012 reflected the establishment of the valuation allowance. Until the valuation allowance is reversed, net income tax expense or benefit reported will be minimal. Income tax expense recorded in the year ended December 31, 2013 related to (1) minimum state tax due each year, and (2) an approximate \$11,000 of alternative minimum tax paid in connection with our filing of an amended 2007 tax return. The tax return was amended during 2013 in order to recognize the gain realized upon the sale of our former Cave Creek utility (see Note 9 of GWRI's audited consolidated financial statements for the year ended December 31, 2013).

**Net Loss** – The Company's net loss totaled \$6.0 million for the year ended December 31, 2013 compared to a net loss of \$38.5 million for the year ended December 31, 2012. This difference was due to several factors as mentioned above, but primarily reflects the \$32.7 million income tax valuation allowance recorded during the year ended December 31, 2012.

**EBITDA** – EBITDA totaled \$12.7 million for the year ended December 31, 2013 compared to \$12.6 million for the year ended December 31, 2012. 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, 2013 and 2012 is as follows (in thousands of US\$):

	Years Ended December 31,	
	2013	2012
<b>Net Loss</b> .....	<b>\$ (6,040)</b>	<b>\$ (38,481)</b>
Income tax expense .....	16	30,667
Interest income .....	(47)	(6)
Interest expense .....	8,935	9,565
Depreciation .....	9,801	10,899
<b>EBITDA<sup>(1)</sup></b> .....	<b>\$ 12,665</b>	<b>\$ 12,644</b>

- (1) EBITDA is defined as net 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, 2013 and 2012 (amounts in thousands of US\$, except share and per share data):

	Net Loss	EBITDA
Amount for the year ended December 31, 2013 .....	\$ (6,040)	\$ 12,665
Weighted average number of GWRI shares outstanding during the year ended December 31, 2013 .....	182,050	182,050
GWRI per share amount <sup>(1)</sup> .....	<u>\$ (33.18)</u>	<u>\$ 69.57</u>
GWRI per share amount, excluding loss on the sale of GWM and the gain on Sale of 303 Contracts <sup>(2)</sup> .....	\$ (40.62)	\$ 62.13
	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, excluding valuation allowance <sup>(3)</sup> .....	\$ (26.44)	\$ 69.45

- (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 \$(0.33) and \$0.70 for the year ended December 31, 2013, respectively, and approximately \$(2.11) and \$0.69 for the year ended December 31, 2012, respectively. EBITDA and EBITDA per share data are not U.S. GAAP measures.
- (2) Excluding the loss on sale of GWM and the gain on Sale of 303 Contracts, GWRI’s net loss and EBITDA totaled \$7,395,000 and \$11,310,000, respectively, for the year ended December 31, 2013.

- (3) Excluding the effect of the valuation allowance, which increased income tax expense, GWRI's net loss for the year ended December 31, 2012 totaled \$(4,813,000).

### Comparison of Results of Operations for the Fourth Quarter of 2013 versus the Fourth Quarter of 2012

**Revenues** – The following table summarizes GWRI's revenues for the three months ended December 31, 2013 and 2012 (in thousands of US\$):

	Three Months Ended December 31,	
	2013	2012
Water services .....	\$ 4,223	\$ 4,156
Wastewater and recycled water services .....	3,498	3,331
Unregulated revenues .....	45	937
Total revenues .....	<u>\$ 7,766</u>	<u>\$ 8,424</u>

Total revenues decreased \$658,000, or 7.8%, for the three months ended December 31, 2013 compared with the three months ended December 31, 2012, reflecting the decrease in unregulated revenues due to the absence of FATHOM<sup>TM</sup>-related revenues which are no longer recorded by the Company subsequent the sale of GWM on June 5, 2013. The decrease was partially offset by the positive impact of increased active service connections for our Regulated division.

*Water Services* - Water services revenues increased \$67,000, or 1.6%, to \$4.2 million for the three months ended December 31, 2013 compared to the three months ended December 31, 2012.

Active water connections increased 4.1% to 25,688 as of December 31, 2013 from 24,681 as of December 31, 2012. As a result of connection growth, water consumption increased to 650 million gallons for the three months ended December 31, 2013 from 627 million gallons for the three months ended December 31, 2012. Despite the higher number of service connections and consumption levels, the positive impact to revenue growth was adversely impacted by weather factors, most notably precipitation, which was 98% higher for the three months ended December 31, 2013 compared to the three months ended December 31, 2012. Water services revenue based on consumption was substantially flat at \$1.6 million for the three months ended December 31, 2013 compared to the same period in 2012 as a result of lower consumption from irrigation customers whose consumption levels place them into tiers subjected to higher rates.

Water services revenue, excluding miscellaneous charges, associated with the basic service charge totaled \$2.5 million for the three months ended December 31, 2013 compared to \$2.4 million for the three months ended December 31, 2012, reflecting growth in total active connections.

*Wastewater and Recycled Water Services* - Wastewater and recycled water services revenues increased \$167,000, or 5.0%, for the three months ended December 31, 2013 compared to the three months ended December 31, 2012. The increase was primarily due to the number of active connections, which increased 4.4% to 17,038 as of December 31, 2013 from 16,327 as of December 31, 2012.

Wastewater revenue, excluding miscellaneous charges, which is billed and recognized at a flat rate per connection, totaled \$3.3 million for the three months ended December 31, 2013 compared to \$3.2 million for the three months ended December 31, 2012.

Recycled water revenue, which is based on gallons delivered, decreased \$2,000, or 2.9%, to \$79,000 for the three months ended December 31, 2013 compared to \$81,000 for the three months ended December 31, 2012. The volume

of recycled water delivered decreased to 139 million gallons for the three months ended December 31, 2013 from 143 million gallons for the three months ended December 31, 2012. The decrease can be attributed to the impact of higher precipitation levels in three months ended December 31, 2013 compared to the three months ended December 31, 2012.

*Unregulated Revenues* – Unregulated revenues totaled \$45,000 for the three months ended December 31, 2013 compared to \$937,000 for the three months ended December 31, 2012, representing a decrease of \$892,000. Historically, unregulated revenues primarily consisted of revenues generated from customers of GWRI's FATHOM™ business. Subsequent to the June 5, 2013 sale of GWM, unregulated revenues have been limited to engineering services and rental revenues, thus the decline comparatively to prior year.

In 2012 we began performing engineering services for third parties which we recognize on a percentage of completion basis. Engineering service revenue totaled \$32,000 and \$86,000 during the three months ended December 31, 2013 and December 31, 2012, respectively, related to the Loop 303 Water Project. With the divestiture of this project, GWRI does not expect any further professional engineering services revenue.

**Operating Expenses** – Operating expenses decreased \$1,825,000, or 22.6%, for the three months ended December 31, 2013 compared to the three months ended December 31, 2012.

The following table summarizes GWRI's operating expenses for the three months ended December 31, 2013 and 2012 (in thousands of US\$):

	<b>Three Months Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Operations and maintenance .....	\$ 2,460	\$ 2,862
General and administrative .....	1,671	2,362
Depreciation .....	2,134	2,866
Total operating expenses .....	<u>\$ 6,265</u>	<u>\$ 8,090</u>

*Operations and Maintenance* – Operations and maintenance costs, consisting of personnel costs, production costs (primarily chemicals and purchased power), maintenance costs, property tax, and formerly costs associated with FATHOM™ decreased \$402,000, or 14.0%, for the three months ended December 31, 2013 compared to the three months ended December 31, 2012.

Personnel costs decreased \$333,000, or 39.0%, in the fourth quarter of 2013 compared to the same period of 2012. The decrease is primarily attributed to the June 5, 2013 sale of GWM whereby GWRI's total employee headcount was reduced from 143 as of December 31, 2012 to 65 as of December 31, 2013.

As a result of the June 5, 2013 sale of GWM, the costs in several operating expense categories associated with the FATHOM™ business decreased. In total, the Company experienced a decrease of \$509,000 for the three months ended December 31, 2013 compared to the same period in 2012 due to lower costs in expense categories such as contract labor, phone and communication expense, computer repairs and maintenance, bank fees, and postage.

By contrast, contract services increased for the fourth quarter of 2013 as compared to the same period in the prior year. The increase is primarily driven by the sale of FATHOM™ on June 5, 2013. Historically, all FATHOM™ Service fees charged by FATHOM™ to GWRI's regulated utilities would eliminate upon consolidation. As a result of the sale, this service fee no longer eliminates, thus resulting in charges totaling \$592,000 during the 2013 period.

*General and Administrative* – General and administrative costs include the day-to-day expenses of office operation; salaries and wages, legal and other professional fees, insurance and regulatory costs. These costs decreased \$691,000, or 29.3%, during the three months ended December 31, 2013 compared to the three months ended December 31, 2012.

Personnel costs remained relatively flat for the three months ended December 31, 2013 compared to the same period in the prior year as a result of offsetting activities. Personnel costs associated with the FATHOM<sup>TM</sup> business totaled \$399,000 for the three months ended December 31, 2012, compared to no such costs for the three months ended December 31, 2013 as a result of the June 5, 2013 sale of GWM. This decrease is offset by an increased bonus accrual, increases in deferred compensation expense as a result of a rising stock price and the addition of one personnel in senior management.

General and administrative costs for most other categories also decreased for three months ended December 31, 2013 compared to the three months ended December 31, 2012. These categories include professional fees, rent, promotion and marketing, bad debt, travel and entertainment, and regulatory-related expenses.

*Depreciation* – Depreciation expense decreased by \$732,000, or 25.5%, to \$2.1 million for the three months ended December 31, 2013 compared to the three months ended December 31, 2012. The decrease reflects the impact of the reduction of FATHOM<sup>TM</sup> related assets from the Company's balance sheet as a result of the sale of GWM. Additionally, amortization of GWRI's CIAC liability balance, which is recorded as a reduction to depreciation, increased from \$324,000 during the three months ended December 31, 2012 to \$637,000 during the three months ended December 31, 2013 as a result of additional contributions in aid of construction beginning to amortize. Such contributions are no longer subject to refunding to the related developer.

**Other Income (Expense)** – Other income (expense) totaled \$1.4 million of net expense for the three months ended December 31, 2013 compared to \$2.1 million of net expense for the three months ended December 31, 2012. Other income (expense) primarily consists of interest expense. Interest expense totaled \$2.4 million and \$2.1 million for the three months ended December 31, 2013 and 2012, respectively. The increase in interest expense was attributed to higher debt issuance cost amortization and higher interest expense under the Company's term loan with Regions bank as a result of the loan agreement amendment, the terms of which became effective December 31, 2012. Also impacting other income (expense) in 2013 that didn't occur in 2012 was a \$1.1 million gain recorded on the Sale of the 303 Contracts, and (ii) a \$308,000 loss on equity method investment related to our investment in FATHOM<sup>TM</sup>.

**Income Tax Benefit (Expense)** – Effective June 30, 2012, a valuation allowance has been established against the Company's net deferred tax assets, and accordingly, the net income tax expense or benefit reported is minimal. Income tax expense recorded in the three months ended December 31, 2013 related to alternative minimum tax paid in connection with an amended 2007 tax return filed during 2013 (see Note 9 of the GWRI audited consolidated financial statements for the year ended December 31, 2013).

**Net Income (Loss)** – The Company's net income totaled \$137,000 for the three months ended December 31, 2013 compared to a net loss of \$1.8 million for the three months ended December 31, 2012. This difference was due to several factors as mentioned above, particularly the \$1.1 million gain recorded during the fourth quarter of 2013 on the Sale of 303 Contracts, as well as eliminating the operating results of the FATHOM<sup>TM</sup> business upon the sale of GWM on June 5, 2013.

**EBITDA** – EBITDA totaled \$4.6 million for the three months ended December 31, 2013 compared to \$3.2 million for the three months ended December 31, 2012. The increase was primarily attributed to the gain recorded on the Sale of the 303 Contracts and the elimination the operating results of the FATHOM<sup>TM</sup> business. For additional discussion, refer to the sections *Revenues* and *Operating Expenses above*.

A reconciliation of Net Loss to EBITDA for the three months ended December 31, 2013 and 2012 is as follows (in thousands of US\$):

	Three Months Ended December 31,	
	2013	2012
<b>Net income (loss)</b> .....	<b>\$ 137</b>	<b>\$ (1,766)</b>
Income tax expense .....	11	6
Interest income .....	(20)	(5)
Interest expense .....	2,351	2,085
Depreciation .....	2,134	2,866
<b>EBITDA <sup>(1)</sup></b> .....	<b>\$ 4,613</b>	<b>\$ 3,186</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 Income (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, 2013 and 2012 (amounts in thousands of US\$, except share and per share data):

	Net Income (Loss)	EBITDA
Amount for the three months ended December 31, 2013 .....	\$ 137	\$ 4,613
Weighted average number of GWRI shares outstanding during the three months ended December 31, 2013 .....	182,050	182,050
GWRI per share amount <sup>(1)</sup> .....	\$ 0.75	\$ 25.34
GWRI per share, excluding the loss on sale of GWM and the gain on Sale of 303 Contracts <sup>(2)</sup> .....	\$ (5.59)	\$ 19.01

	Net Loss	EBITDA
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> .....	\$ (9.70)	\$ 17.50

- (1) Each share of GWRI is approximately equivalent to 100 common shares of GWRC. Therefore, GWRI’s net income (loss) per share and EBITDA per share amounts in terms of GWRC’s common shares is approximately \$0.01 and \$0.25 for the three months ended December 31, 2013, respectively, and approximately \$(0.10) and \$0.18 for the three months ended December 31, 2012, respectively. EBITDA and EBITDA per share data are not U.S. GAAP measures.
- (2) Excluding the loss on the sale of GWM and gain on Sale of 303 Contracts, GWRI’s net loss and EBITDA total \$(1,017,000) and \$3,459,000, respectively, for the three months ending December 31, 2013.

**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. 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.

The following table sets forth unaudited consolidated financial data for the last eight quarters ended December 31, 2013 (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.

	2013				2012			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
<b>REVENUES:</b>								
Water services .....	\$ 4,223	\$ 5,405	\$ 4,973	\$ 3,599	\$ 4,156	\$ 4,863	\$ 4,844	\$ 3,554
Wastewater and recycled water services .....	3,498	3,536	3,482	3,313	3,331	3,328	3,353	3,232
Unregulated revenues .....	45	49	634	677	937	829	572	539
Total revenues .....	7,766	8,990	9,089	7,589	8,424	9,020	8,769	7,325
<b>OPERATING EXPENSES:</b>								
Operations and maintenance .....	2,460	3,043	3,338	3,154	2,862	3,276	2,919	2,937
General and administrative .....	1,671	2,608	2,535	2,809	2,362	2,178	2,457	2,660
Depreciation .....	2,134	2,306	2,664	2,697	2,866	2,662	2,706	2,665
Total operating expenses .....	6,265	7,957	8,537	8,660	8,090	8,116	8,082	8,262
OPERATING INCOME (LOSS) .....	1,501	1,033	552	(1,071)	334	904	687	(937)
<b>OTHER INCOME (EXPENSE):</b>								
Interest income .....	20	20	6	1	5	1	-	-
Interest expense .....	(2,351)	(2,209)	(2,136)	(2,239)	(2,085)	(2,245)	(3,005)	(2,230)
Other .....	978	1,818	(1,964)	17	(14)	723	54	(6)
Total other income (expense) .....	(1,353)	(371)	(4,094)	(2,221)	(2,094)	(1,521)	(2,951)	(2,236)
INCOME (LOSS) BEFORE INCOME TAXES .....	148	662	(3,542)	(3,292)	(1,760)	(617)	(2,264)	(3,173)
INCOME TAX (EXPENSE) BENEFIT .....	(11)	(2)	(1)	(2)	(6)	-	(31,885)	1,224
NET INCOME (LOSS) .....	\$ 137	\$ 660	\$ (3,543)	\$ (3,294)	\$ (1,766)	\$ (617)	\$ (34,149)	\$ (1,949)
<b>LOSS, EXCLUDING GAIN ON SALE OF 303 CONTRACTS, LOSS ON THE SALE OF GWM AND TAX VALUATION ALLOWANCE .....</b>								
	\$ (1,017)	\$ (1,475)	\$ (1,609)	\$ (3,294)	\$ (1,073)	\$ (397)	\$ (1,394)	\$ (1,949)



## Business Divisions

The following table summarizes GWRI's operating results by business division for the three months ended and years ended December 31, 2013 and 2012 (in thousands of US\$):

	Regulated	Unregulated	Other	Eliminations	Total
<b>Three months ended December 31, 2013</b>					
Revenues.....					
Recurring .....	\$ 7,734	\$ -	\$ -	\$ -	\$ 7,734
Non recurring.....	32	-	-	-	32
Operations and Maintenance.....					
Recurring .....	2,440	-	-	-	2,440
Non recurring.....	20	-	-	-	20
General and Administrative .....	1,671	-	-	-	1,671
Depreciation.....	2,134	-	-	-	2,134
Operating income.....	1,501	-	-	-	1,501
Other income (expense) .....	1,111	-	(2,464)	-	(1,353)
Income (loss) before income taxes.....	2,612	-	(2,464)	-	148
Income tax expense.....	-	-	(11)	-	(11)
Net Income (Loss) .....	\$ 2,612	\$ -	\$ (2,475)	\$ -	\$ 137
EBITDA <sup>(1)</sup> .....	\$ 4,788	\$ -	\$ (175)	\$ -	\$ 4,613
<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.....	-	(6)	-	-	(6)
Net Income (Loss) .....	\$ 1,482	\$ (1,210)	\$ (2,038)	\$ -	\$ (1,766)
EBITDA <sup>(1)</sup> .....	\$ 3,929	\$ (743)	\$ -	\$ -	\$ 3,186

	Regulated	Unregulated	Other	Eliminations	Total
<b>Years Ended December 31, 2013</b>					
Revenues.....					
Recurring .....	\$ 32,084	\$ 1,942	\$ -	\$ (752)	\$ 33,274
Non recurring.....	160	-	-	-	160
Operations and Maintenance.....					
Recurring .....	9,404	2,486	-	-	11,890
Non recurring.....	92	13	-	-	105
General and Administrative .....	8,384	1,991	-	(752)	9,623
Depreciation.....	8,776	1,025	-	-	9,801
Operating income (loss).....	5,588	(3,573)	-	-	2,015
Other income (expense).....	3,197	(12)	(11,224)	-	(8,039)
Income (loss) before income taxes.....	8,785	(3,585)	(11,224)	-	(6,024)
Income tax expense.....	-	(3)	(13)	-	(16)
Net Income (Loss) .....	\$ 8,785	\$ (3,588)	\$ (11,237)	\$ -	\$ (6,040)
EBITDA <sup>(1)</sup> .....	\$ 17,720	\$ (2,550)	\$ (2,505)	\$ -	\$ 12,665
<b>Years 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.....	(24,028)	(543)	(6,096)	-	(30,667)
Net Loss .....	\$ (18,985)	\$ (5,902)	\$ (13,594)	\$ -	\$ (38,481)
EBITDA <sup>(1)</sup> .....	\$ 15,675	\$ (3,793)	\$ 762	\$ -	\$ 12,644

(1) EBITDA data are not U.S. GAAP measures.

*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 \$193,000, or 2.5%, for the three months ended December 31, 2013 compared with the three months ended December 31 2012; and increased \$1.5 million, or 4.9%, for the year ended December 31, 2013 compared with the year ended December 31, 2012. The primary factor impacting revenue was the growth in the number of active service connections.

In late 2012 we began performing engineering services for third parties which we recognized on a percentage of completion basis. Engineering service revenue totaled \$32,000 and \$160,000 during the three months and year

ended December 31, 2013, respectively. 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 Regulated division experienced a general increase in operating expenses. The increase was primarily attributable by the inclusion of the service fees paid to FATHOM™, which no longer eliminates in consolidation after the June 5, 2013 sale of GWM higher, higher deferred compensation resulting from an increased stock price, higher property tax, higher variable costs associated with servicing a larger number of service connections, and the recording of a \$442,000 write-off of costs in connection with the rate case settlement.

Historically, fees paid to FATHOM™ were included within general and administrative expenses. These costs were then eliminated in consolidation along with revenues of the Unregulated division. Effective June 5, 2013, the fees paid to FATHOM™ are included within operations and maintenance expenses as such costs are necessary for the day-to-day operations of the utilities.

Other income (expense) for the Regulated division consists of the gain recognized during the 2013 periods related to the Sale of the 303 Contracts.

*Unregulated* – The Company's Unregulated division has historically consisted of the FATHOM™ business which was owned by GWRI's former subsidiary GWM. As discussed above, GWM was sold on June 5, 2013, and consequently, no Unregulated division activity is reported for the three months ended December 31, 2013. For the three months ended December 31, 2012, revenues of our Unregulated division before intercompany eliminations totaled \$1.3 million; and totaled \$3.2 million and \$4.5 million in the years ended December 31, 2013 and 2012, respectively.

The Company's Unregulated division historically considered the Regulated division as a FATHOM™ client. GWM has provided the same or similar services to the Regulated division as it provides third party FATHOM™ clients. Through the date of the sale of GWM on June 5, 2013, fees charged by FATHOM™ to the Regulated division totaled \$0.8 million during 2013. In 2012, fees charged to the Regulated division by FATHOM™ totaled \$0.4 million and \$1.7 million for the three months and year ended December 31, 2012, respectively. Such fees are included in revenues of the Unregulated division and in expenses of the Regulated division in the table above, and prior to the sale of GWM, these amounts were eliminated in consolidation.

*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 primarily included interest on parent company debt, which is not allocated to the other divisions. For the year ended December 31, 2013, this category also includes the \$1.9 million loss on the sale of GWM, the \$0.7 million equity method loss recorded to-date as a result of losses incurred by FATHOM™ subsequent to June 5, 2013, approximately \$47,000 of interest income related to our convertible promissory notes, and approximately \$112,000 of earn-out royalties received from FATHOM™.

### **Outstanding Share Data**

As of March 25, 2014, 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 and debt financing. Additionally, GWRI's regulated utility subsidiaries receive advances and contributions from 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, 2013, is in a net deficit position.

As discussed in Notes 1 and 7 to GWRI's 2013 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. In addition, during the first quarter of 2014, we received \$5.3 million from SNR in connection with the arbitration award (see Note 12 to GWRI's consolidated financial statements for the year ended December 31, 2013).

As of December 31, 2013, GWRI's near-term cash expenditure obligations include approximately \$4.0 million of debt interest payments due June 2014 and approximately \$8.0 million of debt interest and principal payments due December 2014. While specific facts and circumstances could change, we believe we will be able to generate sufficient cash flows in excess of our required debt service and operating and capital expenditures cash flow requirements.

**Cash Flows from Operating Activities** – Cash flows from operating activities are used for operating needs and to meet capital expenditure requirements. 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, and weather and seasonality.

The following table provides a summary of the major items affecting GWRI's cash flows from operating activities for the years ended December 31, 2013 and 2012 (in thousands of US\$):

	<b>Years Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Net income (loss).....	\$ (6,040)	\$ (38,481)
Add (subtract):		
Non-cash operating activities <sup>(1)</sup> .....	10,305	42,610
Changes in working capital <sup>(2)</sup> .....	(2,442)	680
Changes in noncurrent assets and liabilities .....	246	259
Net cash provided by operating activities .....	<u>\$ 2,069</u>	<u>\$ 5,068</u>

(1) Includes deferred compensation, depreciation, gains and losses, interest accretion, income tax expense (benefit), and provision for losses on accounts receivable.

(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, 2013, GWRI's net cash provided by operating activities totaled \$2.1 million compared to net cash provided by operating activities of \$5.1 million for the year ended December 31, 2012. The decrease experienced between these periods was most notably driven by the delay in timing between when the Company's utility customers make payment and when such payments are remitted to the Company from FATHOM™ as well as other miscellaneous amounts due from FATHOM™ related to the transition (most of which was paid shortly after December 31, 2013).

**Cash Flows from Investing Activities** – Cash flows provided by (used in) investing activities for the years ended December 31, 2013 and 2012 were as follows (in thousands of US\$):

	<b>Years Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Capital expenditures .....	\$ (5,294)	\$ (5,174)
Other investing activities, net <sup>(1)</sup> .....	4,732	(2,645)
Net cash used in investing activities .....	<u>\$ (562)</u>	<u>\$ (7,819)</u>

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

For the year ended December 31, 2013, GWRI's net cash used in investing activities totaled \$0.6 million compared to net cash used in investing activities of \$7.8 million for the year ended December 31, 2012. The fluctuation was primarily attributable to the receipt of \$3.1 million in connection with the Sale of the 303 Contracts and the receipt of approximately \$1.8 million in net cash from the sale of GWM. For the year ended December 31, 2012, net cash from investing activities was particularly impacted by an additional \$2.4 million paid into the bond service fund due to the June 2012 financings.

For the near term, GWRI intends to invest capital prudently in its existing, core service areas where GWRI is able to deploy its TWM model and as service connections grow. This will primarily include any required maintenance capital expenditures 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.

Capital expenditures related to the FATHOM™ business totaled approximately \$2.7 million during the year ended December 31, 2013. The remaining portion of capital expenditures related to GWRI's regulated division and was higher than expected due to an unplanned capital project, additional IT infrastructure needed as a result of the divestiture of the FATHOM™ business, and certain costs incurred during 2013 that will ultimately be reimbursed in 2014.

**Cash Flows from Financing Activities** – GWRI's net cash used in financing activities totaled \$3.4 million for the year ended December 31, 2013 compared to net cash provided by financing activities of \$4.3 million for the year ended December 31, 2012. GWRI's financing activities during 2012 and 2013 included refund payments of advances for construction, receipt of advances in aid of construction, debt issuance costs, and principal payments made under capital leases. 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 West Maricopa Combine acquisition liability in the first quarter of 2012. During the second quarter of 2012, we refinanced the \$7.0 million Regions Bank loan 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 deposited into an escrow account and used to repay the WIFA loans through 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 during the year ended December 31, 2012, related to scheduled payments for the WMC acquisition.

## Regulatory Restrictions

The issuance of long-term debt securities by GWRI does not require authorization of the ACC if no guarantee 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 is limited to remitting distributions to the amount of current year earnings until a surplus in equity exists. 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, 2013 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>	\$ 132,957	\$ 4,086	\$ 9,311	\$ 10,015	\$ 109,545
Interest on long term debt <sup>(3)</sup>	123,728	8,074	15,249	14,813	85,592
Capital lease obligation	332	86	149	97	-
Interest on capital lease	58	23	29	6	-
<b>Total</b>	<b>\$ 257,075</b>	<b>\$ 12,269</b>	<b>\$ 24,738</b>	<b>\$ 24,931</b>	<b>\$ 195,137</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, 2013 totaled \$379,000 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 \$61,000 and \$53,000 increase in GWRI's pre-tax loss for the years ended December 31, 2013 and 2012, respectively. 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 over the long-term 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 GWRI's most recent Annual Information Form, which is available on GWRI's SEDAR profile at [www.sedar.com](http://www.sedar.com).

### **Related Party Transactions**

See Note 7 to GWRI's audited consolidated financial statements for the year ended December 31, 2013.

### **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 2013 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, 2013, and has concluded that such internal control over financial reporting is effective as of December 31, 2013. 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 25, 2014

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, 2013. 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, 2013 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. Bowers  
Executive Vice President and Chief Financial Officer



# **GWR GLOBAL WATER RESOURCES CORP.**

FINANCIAL STATEMENTS AS OF AND FOR THE YEARS  
ENDED DECEMBER 31, 2013 AND 2012

## **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, 2013 and 2012, 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, 2013 and 2012, 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 25, 2014

**GWR GLOBAL WATER RESOURCES CORP.**  
**BALANCE SHEETS**  
**As of December 31, 2013 and 2012**

	<u>Notes</u>	<u>December 31, 2013</u>	<u>December 31, 2012</u>
		(in thousands of US\$, except share data)	
<b>ASSETS</b>			
<b>CURRENT ASSETS:</b>			
Cash and cash equivalents .....		\$ -	\$ -
Other current assets .....		-	1
Total current assets .....		-	1
Equity method investment.....	3	30,962	34,852
<b>TOTAL ASSETS</b> .....		<b>\$ 30,962</b>	<b>\$ 34,853</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>LIABILITIES:</b>			
Accounts payable and accrued expenses .....		\$ 10	\$ 32
Other noncurrent liabilities.....		72	41
Total liabilities .....		82	73
<b>COMMITMENTS AND CONTINGENCIES</b> (see Note 8)			
<b>SHAREHOLDERS' EQUITY:</b>			
Common stock, unlimited shares authorized, 8,754,612 shares issued and outstanding at December 31, 2013 and 2012 .....	6	55,815	55,767
Accumulated deficit .....		(24,935)	(20,987)
Total shareholders' equity .....		30,880	34,780
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY ..</b>		<b>\$ 30,962</b>	<b>\$ 34,853</b>

See accompanying notes to the financial statements.

**GWR GLOBAL WATER RESOURCES CORP.**  
**STATEMENTS OF OPERATIONS**  
**For the Years Ended December 31, 2013 and 2012**

	<u>2013</u>	<u>2012</u>
	(in thousands of US\$, except share and per share data)	
LOSS FROM EQUITY INVESTMENT .....	\$ (3,628)	\$ (18,694)
OPERATING EXPENSES .....	320	397
OPERATING LOSS .....	<u>(3,948)</u>	<u>(19,091)</u>
LOSS BEFORE INCOME TAXES .....	(3,948)	(19,091)
INCOME TAX BENEFIT .....	-	-
NET LOSS .....	<u><u>\$ (3,948)</u></u>	<u><u>\$ (19,091)</u></u>
WEIGHTED AVERAGE SHARES:		
Basic .....	8,754,612	8,754,612
Diluted .....	8,754,612	8,754,612
LOSS PER SHARE:		
Basic .....	\$ (0.45)	\$ (2.18)
Diluted .....	\$ (0.45)	\$ (2.18)

See accompanying notes to the financial statements.



**GWR GLOBAL WATER RESOURCES CORP.**  
**STATEMENTS OF SHAREHOLDERS' EQUITY**  
**For the Years Ended December 31, 2013 and 2012**

	<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, 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
Stock-based compensation.....	-	48	-	48
Net loss .....	-	-	(3,948)	(3,948)
	<hr/>	<hr/>	<hr/>	<hr/>
BALANCE – December 31, 2013.....	<u>8,754,612</u>	<u>\$ 55,815</u>	<u>\$ (24,935)</u>	<u>\$ 30,880</u>

See accompanying notes to the financial statements.

**GWR GLOBAL WATER RESOURCES CORP.**  
**STATEMENTS OF CASH FLOWS**  
**For the Years Ended December 31, 2013 and 2012**

	<u>2013</u>	<u>2012</u>
	(in thousands of US\$)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss .....	\$ (3,948)	\$ (19,091)
Adjustments to reconcile net loss to net cash used in operating activities:		
Deferred compensation.....	25	51
Loss from equity investment .....	3,628	18,694
Changes in assets and liabilities .....	9	(217)
Net cash used in operating activities .....	<u>(286)</u>	<u>(563)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net cash provided by financing activities.....	<u>-</u>	<u>-</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Deemed distribution from related party .....	286	563
Net cash provided by investing activities .....	<u>286</u>	<u>563</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>
<b>Supplementary disclosure:</b>		
Income taxes paid.....	\$ -	\$ -
Interest paid.....	\$ -	\$ -

See accompanying notes to the 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. GWRI’s utilities are regulated by the Arizona Corporation Commission.

Leveraging its investment in technology that was initially developed to support and optimize its own utilities, GWRI historically also operated an unregulated business, whose services were 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 third party services to municipalities and private utilities. The services offered by FATHOM™ provide automation, cost savings and opportunities for increased revenues. On June 5, 2013, GWRI sold a majority interest in the FATHOM™ business and retained an approximate 12.7% interest, which is being reflected as an equity method investment at GWRI.

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 25, 2014, the date on which the financial statements were approved by the board of directors.

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

**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 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.

**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).

## **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.

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

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.

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.

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

**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).

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 would 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. Prior to the sale of the FATHOM™ business (See Note 1), amortization of the intangible asset and the reversal of the deferred tax liability was recorded each period as a component of the Company's income (loss) from equity investment. However, as a result of the sale of the FATHOM™ business, we determined that it would be appropriate to fully amortize the intangible asset since GWRI no longer owns the FATHOM™ contracts. Accordingly, during the year ended December 31, 2013, the Company wrote-off the remaining \$0.9 million intangible balance, and reversed the remaining \$0.2 million of the deferred tax liability.

Exclusive of the write-off of the intangible balance and reversal of the deferred tax liability discussed above, approximately \$68,000 and \$137,000 of the intangible assets were amortized and approximately \$16,000 and \$36,000 of the deferred tax liabilities were reversed during the year ended December 31, 2013 and 2012, respectively.

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

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

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 \$3,628,000 and \$18,694,000 for the years ended December 31, 2013 and 2012, respectively. To date, no distributions have been declared or received from investments. The decreased loss on equity investment for the year ended December 31, 2013 compared with the prior year was primarily a result of a valuation allowance recorded against GWRI's net deferred tax assets during the year ended December 31, 2012.

The following contains summarized financial data of GWRI's financial position as of December 31, 2013 and 2012 (in thousands of US\$):

	<b>December 31, 2013</b>	<b>December 31, 2012</b>
<b>ASSETS:</b>		
Net property, plant and equipment .....	\$ 249,010	\$ 260,236
Current assets .....	7,010	8,750
Other assets .....	30,690	30,411
<b>TOTAL ASSETS.....</b>	<b>\$ 286,710</b>	<b>\$ 299,397</b>
<b>LIABILITIES:</b>		
Current liabilities.....	\$ 12,338	\$ 14,707
Noncurrent liabilities.....	307,214	311,254
<b>TOTAL LIABILITIES .....</b>	<b>319,552</b>	<b>325,961</b>
<b>SHAREHOLDERS' EQUITY (DEFICIT).....</b>	<b>(32,842)</b>	<b>(26,564)</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT) .....</b>	<b>\$ 286,710</b>	<b>\$ 299,397</b>

The following contains summarized financial data of GWRI's results of operations for the years ended December 31, 2013 and 2012 (in thousands of US\$):

	<b>Years Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Revenues.....	\$ 33,434	\$ 33,538
Operating expenses .....	31,419	32,550
Operating income .....	2,015	988
Total other expense, net.....	(8,039)	(8,802)
Loss before income taxes.....	(6,024)	(7,814)
Income tax expense .....	(16)	(30,667)
<b>Net loss .....</b>	<b>\$ (6,040)</b>	<b>\$ (38,481)</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. Through December 31, 2013, GWRI's results of operations were below GWRI's previous forecasts, primarily due to slower than expected growth of the FATHOM™ business. This combined with the lower trading price of our stock relative to the price at the Offering warranted a review of the carrying value of our investment in



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

GWRI for impairment. Accordingly, we performed a valuation assessment during 2013 and concluded that an impairment of the investment in GWRI did not exist as of December 31, 2013. 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.

Since the date of the Offering through December 31, 2013, GWRC has recorded significant equity investment losses as a result of losses generated by GWRI. However, in February 2014, GWRI completed the regulatory rate case which was initiated by GWRI's utility companies in 2011. The regulatory rate case will provide, among other things, additional revenues to GWRI which will be phase-in over time. The Company and GWRI are currently evaluating the impact of the rate case decision, including whether sufficient evidence exists that GWRI's net deferred tax assets will be utilized in the future; thus allowing the reversal of the valuation allowance currently recorded at GWRI. With the exception of the phase-in of new rates to be charged to GWRI's utility customers, we expect that the impact of the rate decision will be effective for GWRI in the first quarter of 2014. We anticipate that the impact of the rate decision, combined with the anticipated effect of reversing the valuation allowance, will result in approximately \$60 million of additional income in GWRI's financial statements to be reported in the three months ended March 31, 2014. Assuming GWRC will pick-up approximately \$28.9 million (\$60 million multiplied by GWRC's 48.1% interest) of equity method earnings as a result of GWRI's gain, we expect that the carrying value of GWRC's investment in GWRI will increase significantly during the three months ended March 31, 2014. Please see the accompanying discussion and analysis of GWRI for more details regarding the completion of the regulatory rate case.

We are currently evaluating the impact of this potentially significant increase to the carrying value of the Company's investment. However, to the extent that the carrying value of the investment exceeds its fair value, a partial impairment of the investment may be recorded.

#### **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;

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

- 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.

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 during the year ended December 31, 2013 totaled \$286,000, and total approximately \$849,000 since the Company's incorporation in 2010. Prior to 2012, the Company 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.

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.

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

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 remeasured the fair value of the award at the end of each period until the options became fully vested on December 31, 2013.

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 \$25,000 and \$51,000 for the years ended December 31, 2013 and 2012, respectively, 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.

Due to attrition and the sale of FATHOM™, certain former employees of GWRI forfeited their stock options during the year ended December 31, 2013. The number of stock options forfeited totaled 107,186.

## **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 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, 2012, the book versus tax basis difference in the Company's equity investment totaled approximately \$20.8 million and a corresponding deferred tax asset was recorded in the amount of \$5.5 million based on a combined statutory tax rate of 26.5%. At December 31, 2013, the book versus tax basis difference in the Company's equity investment totaled approximately \$24.7 million and a deferred tax asset was recorded in the amount of \$6.2 million based on a combined statutory tax rate of 25%. 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.

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

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%.

**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.

\* \* \* \* \*



# **GLOBAL WATER RESOURCES, INC.**

**CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR  
THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

## 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, 2013 and 2012, 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, 2013 and 2012, 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 25, 2014



**GLOBAL WATER RESOURCES, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**As of December 31, 2013 and December 31, 2012**

	<b>December 31, 2013</b>	<b>December 31, 2012</b>
	(in thousands of US\$, except share data)	
<b>ASSETS</b>		
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
Property, plant and equipment .....	\$ 317,319	\$ 321,697
Less accumulated depreciation .....	(68,309)	(61,461)
Net property, plant and equipment .....	<u>249,010</u>	<u>260,236</u>
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents .....	1,960	3,816
Accounts receivable – net .....	1,474	1,926
Other receivables .....	8	215
Due from related party .....	939	-
Accrued revenue .....	1,809	1,599
Restricted cash .....	197	-
Prepaid expenses and other current assets .....	623	1,194
Total current assets .....	<u>7,010</u>	<u>8,750</u>
<b>OTHER ASSETS:</b>		
Goodwill .....	13,082	13,082
Intangible assets – net .....	1,545	1,545
Regulatory assets .....	400	715
Deposits .....	28	43
Bond service fund and other restricted cash .....	11,383	11,383
Debt issuance costs - net .....	3,361	3,643
Convertible note .....	750	-
Equity method investment .....	141	-
Total other assets .....	<u>30,690</u>	<u>30,411</u>
<b>TOTAL</b> .....	<u>\$ 286,710</u>	<u>\$ 299,397</u>
<b>LIABILITIES AND EQUITY (DEFICIT)</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable .....	1,778	\$ 3,676
Accrued expenses .....	3,793	4,263
Deferred revenue – current portion .....	16	1,000
Customer and meter deposits .....	2,579	2,565
Long-term debt – current portion .....	4,172	3,203
Total current liabilities .....	<u>12,338</u>	<u>14,707</u>
<b>NONCURRENT LIABILITIES:</b>		
Long-term debt .....	128,738	132,770
Advances in aid of construction .....	97,253	100,192
Contributions in aid of construction – net .....	74,774	71,879
Deferred income tax liability .....	589	589
Acquisition liability .....	4,688	4,688
Other noncurrent liabilities .....	1,172	1,136
Total noncurrent liabilities .....	<u>307,214</u>	<u>311,254</u>
Total liabilities .....	<u>319,552</u>	<u>325,961</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, 2013 and December 31, 2012 .....	2	2
Paid in capital .....	55,048	55,286
Accumulated deficit .....	(87,892)	(81,852)
Total equity (deficit) .....	<u>(32,842)</u>	<u>(26,564)</u>
<b>TOTAL</b> .....	<u>\$ 286,710</u>	<u>\$ 299,397</u>

See accompanying notes to the consolidated financial statements

**GLOBAL WATER RESOURCES, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the Years Ended December 31, 2013 and 2012**

	<b>2013</b>	<b>2012</b>
	(in thousands of US\$)	
REVENUES:		
Water services.....	\$ 18,200	\$ 17,417
Wastewater and recycled water services .....	13,829	13,244
Unregulated revenues.....	1,405	2,877
Total revenues .....	<u>33,434</u>	<u>33,538</u>
OPERATING EXPENSES:		
Operations and maintenance .....	11,995	11,994
General and administrative .....	9,623	9,657
Depreciation.....	9,801	10,899
Total operating expenses .....	<u>31,419</u>	<u>32,550</u>
OPERATING INCOME.....	<u>2,015</u>	<u>988</u>
OTHER INCOME (EXPENSE):		
Interest income.....	47	6
Interest expense .....	(8,935)	(9,565)
Other.....	849	757
Total other income (expense) .....	<u>(8,039)</u>	<u>(8,802)</u>
LOSS BEFORE INCOME TAXES.....	(6,024)	(7,814)
INCOME TAX EXPENSE.....	(16)	(30,667)
NET LOSS .....	<u>\$ (6,040)</u>	<u>\$ (38,481)</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, 2013 and 2012**

	Common Stock	Paid-in Capital	Accumulated Deficit	Total Equity (Deficit)
		(in thousands of US\$)		
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 .....	<u>\$ 2</u>	<u>\$ 55,286</u>	<u>\$ (81,852)</u>	<u>\$ (26,564)</u>
Stock-based compensation .....	-	48	-	48
Deemed distribution to related party .....	-	(286)	-	(286)
Net loss .....	-	-	(6,040)	(6,040)
BALANCE – December 31, 2013 .....	<u>\$ 2</u>	<u>\$ 55,048</u>	<u>\$ (87,892)</u>	<u>\$ (32,842)</u>

See accompanying notes to the consolidated financial statements

**GLOBAL WATER RESOURCES, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Years Ended December 31, 2013 and 2012**

	2013	2012
	(in thousands of US\$)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss .....	\$ (6,040)	\$ (38,481)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Deferred compensation.....	576	357
Depreciation .....	9,801	10,899
Amortization of deferred debt issuance costs and discounts .....	435	353
Write-off of debt issuance costs .....	-	618
(Gain) on sale of 303 contracts (Note 1).....	(3,265)	-
Loss on disposal of fixed and intangible assets .....	2	19
Loss on disposal of GWM net assets.....	1,934	-
(Gain) loss on equity method investment .....	707	-
Imputed interest expense on deferred payments for acquisitions – net of cash paid .....	-	(463)
Provision for doubtful accounts receivable.....	99	160
Deferred income tax expense (benefit).....	16	30,667
Changes in assets and liabilities – excluding effects of acquisitions:		
Accounts receivable.....	(302)	658
Other current assets.....	(2,353)	(807)
Accounts payable and other current liabilities .....	213	829
Other noncurrent assets.....	352	(354)
Other noncurrent liabilities .....	(106)	613
Net cash provided by operating activities .....	<u>2,069</u>	<u>5,068</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures .....	(5,294)	(5,174)
Proceeds from disposal of fixed and intangible assets .....	13	-
Net cash received from the sale of GWM.....	1,771	-
Proceeds received from the sale of 303 contracts.....	3,130	-
Deposits into restricted cash .....	(197)	(2,645)
Deposits received.....	15	-
Net cash used in investing activities .....	<u>(562)</u>	<u>(7,819)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from bonds.....	-	14,000
Repayments of bonds.....	(2,475)	(2,090)
Loan borrowings.....	-	18,000
Loan repayments.....	(605)	(15,526)
Principal payments under capital lease .....	(84)	(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 .....	(195)	(1,465)
Acquisition of utilities – deferred acquisition payments .....	-	(11,163)
Cash advances in aid of construction .....	460	760
Contributions in aid of construction under ICFA and other agreements .....	221	2,421
Refunds of advances for construction .....	(685)	(551)
Net cash provided by (used in) financing activities .....	<u>(3,363)</u>	<u>4,334</u>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS .....</b>	<b>(1,856)</b>	<b>1,583</b>
<b>CASH AND CASH EQUIVALENTS – Beginning of year .....</b>	<b>3,816</b>	<b>2,233</b>
<b>CASH AND CASH EQUIVALENTS – End of year .....</b>	<b>\$ <u>1,960</u></b>	<b>\$ <u>3,816</u></b>

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.

Leveraging its investment in technology that was initially developed to support and optimize its own utilities, GWRI also has operated an Unregulated business, whose services were marketed by GWRI’s subsidiary Global Water Management LLC (“GWM”) as FATHOM Utility-to-Utility (“U<sub>2</sub>U™”) Solutions (“FATHOM™”). FATHOM™ offers an integrated suite of cloud-based geo-spatial advanced technology-enabled platforms to provide third party services to municipalities and private utilities of any size. The services offered by FATHOM™ provide automation, cost savings and opportunities for increased revenues to GWM’s municipal and private utility clients. On June 5, 2013, GWRI sold GWM and now owns a minority interest in the FATHOM™ business. See further discussion regarding the sale of GWM below.

**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.

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

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.

GWI 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 Certificate of Convenience and Necessity (“CC&N”) for Picacho, granting it the exclusive right to provide services to 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.

**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™ business, was reorganized from a limited liability company into Global Water Management, Inc. The reorganization was made to facilitate the growth of FATHOM™ by allowing the entity that owns FATHOM™ to hold contractors’ licenses in certain states that do not allow limited liability companies to be contractors. Subsequently, in April 2013, GWM was reorganized back into limited liability company in anticipation of the sale of GWM, discussed below.

**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.

**Corporate Transactions** — *WMC acquisition* — As mentioned above, on July 11, 2006, we acquired 100% of the outstanding common shares of 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

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

the Company over time. In March 2012, we made the final payment for this acquisition in the amount of approximately \$11.9 million.

*Sale of Global Water Management, LLC* — On June 5, 2013, the Company sold Global Water Management, LLC (GWM) to an investor group led by a private equity firm that specializes in the water industry. As mentioned above, GWM was a wholly owned subsidiary of GWRI that owns and operates the FATHOM™ business, which historically served as one of GWRI's two business divisions.

The transaction was effected through the sale of all of the outstanding membership interests of GWM to a wholly owned subsidiary of Fathom Water Management Holdings, LLP (the "FATHOM™ Partnership"). The Company received the following consideration for the sale of GWM: (a) a cash payment of \$4.25 million (subject to a post-closing working capital adjustment resulting in a \$1.7 million liability for the Company, which the Company has paid as of December 31, 2013); and (b) the issuance to the Company of common and preferred units of the FATHOM™ Partnership valued at approximately \$0.8 million (see Note 5). In addition, the Company is entitled to quarterly royalty payments based on a percentage of certain of GWM's recurring revenues for a 10-year period, up to a maximum of \$15.0 million.

The Company has made the election to record these quarterly payments prospectively in income as the amounts are earned. As of December 31, 2013, royalty payments earned have totaled approximately \$112,000.

Including the working capital adjustment, the following table summarizes the asset and liability balances sold by major classifications (in thousands of US\$):

Net property, plant and equipment.....	\$ 6,560
Total current assets <sup>(1)</sup> .....	5,486
Total other assets .....	-
Total assets.....	<u>\$ 12,046</u>
Total current liabilities.....	\$ 4,952
Total noncurrent liabilities.....	499
Total liabilities.....	<u>\$ 5,451</u>

(1) Total current assets included approximately \$1.8 million of cash.

Based on the above, and exclusive of any future quarterly royalty payments, the Company recorded a loss on the sale of GWM in the amount of \$1.9 million, which is included within other income (expense) in the Company's statement of operations for the year ended December 31, 2013. Included within the \$1.9 million amount is approximately \$0.5 million in legal and other transaction related costs associated with completing the sale of GWM.

Concurrent with the closing, \$750,000 of the cash portion of the purchase price was reinvested by the Company in a convertible promissory note issued by GWM's parent. The promissory note is due December 31, 2014, bears interest at a rate of 10% per annum and is convertible into equity of the FATHOM™ Partnership.

The Company will continue to hold an indirect interest in GWM through its ownership of the common and preferred units of the FATHOM™ Partnership received in consideration for the sale of GWM. Together, these units represent an approximate 12.7% ownership interest in the FATHOM™ Partnership (on a fully diluted basis).

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

The sale of GWM was effected as an asset sale for income tax purposes. The Company expects to recognize a current taxable gain on the sale of approximately \$3.1 million. The Company also intends to elect the installment sale method for tax purposes, and accordingly, will recognize gain in subsequent periods as additional royalty payments are received. Tax attributes that may have been generated by GWM operations, such as a net operating loss, will continue to be available to the Company to utilize in 2013 and future years. The Company continues to evaluate the tax basis in the assets sold and in the 12.7% ownership in the FATHOM™ Partnership. However, due to the full valuation allowance recorded against the net deferred tax assets of the Company, there has been no significant impact on the Company's overall tax position as of December 31, 2013.

GWM has historically provided billing, customer service and other support services for the Company's regulated utilities. The Company has entered into a services agreement with GWM whereby the Company has agreed to use the FATHOM™ platform for all of its regulated utility services for an initial term of 10 years. The services agreement is automatically renewable thereafter for successive 10-year periods, unless notice of termination is given prior to any renewal period. The services agreement may be terminated by either party for default only and the termination of the services agreement will also result in the termination of the royalty payments payable to the Company. The sale of GWM has resulted in changes to the recurring costs to be recorded by the Company. Based on current customer service connections, we estimate that costs to be paid to GWM for FATHOM™ services will be \$7.69 per water account/month, an annual rate of approximately \$2.4 million.

*Sale of certain MXA and WMA contracts* — In October 2012, GWRI, GWRI's subsidiary Global Water – 303 Utilities Company, Inc. ("303 Utilities Company"), and the City of Glendale (the "City") entered into an agreement for future wastewater and recycled water services, advancing GWRI's public-private-partnership originally established in a Memorandum of Understanding approved by the City in March 2010. The agreement named 303 Utilities Company as the future wastewater and recycled water provider for a 7,000-acre territory within a portion of the City's western planning area known as the Loop 303 Corridor ("303 Corridor").

The 303 Utilities Company had also signed Wastewater Facilities Main Extension Agreements ("MXA") with numerous developers/landowners in the service area to fund the initial design and construction of a wastewater and recycled water utility.

In addition, GWRI had signed separate Offsite Water Management Agreements ("WMA") with the same developers/landowners to provide the coordination, permitting, and engineering work for the related water utility service element of the project (note, whereas the 303 Utilities Company had agreements with the developers/landowners to service wastewater and recycled water, the Company did not have the rights to service *water*).

In September 2013, the Company sold the MXAs and WMAs along with their related rights and obligations to a third party (the "Transfer of Project Agreement", or "Sale of 303 Contracts"). Pursuant to the Transfer of Project Agreement, GWRI will receive total proceeds of approximately \$4.1 million over a multi-year period. As part of the consideration, GWRI agreed to complete certain engineering work required in the WMAs, which work had been completed as of December 31, 2013. Since this engineering work has been completed, the Company effectively has no further obligations under the WMAs, MXAs or the Transfer of Project Agreement. Through December 31, 2013, the Company has received \$2.8 million of proceeds and has recognized income of approximately \$3.3 million within other income (expense) in the statement of operations. Receipt of the remaining \$1.3 million of proceeds will occur and be recorded as additional income over time as certain milestones are met between the third party acquirer and the developers/landowners.



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

**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 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 to adjust the revenue requirements for seven utilities representing a collective rate increase of approximately 28% over 2011’s revenue. In August 2013, the Company entered into a settlement agreement with ACC Staff, the Residential Utility Consumers Office, the City of Maricopa, and other the parties to the rate case. The settlement required approval by the ACC’s Commissioners before it could take effect. In February 2014, the rate case proceedings were completed and the ACC issued Rate Decision No. 74364, effectively approving the settlement agreement. See Note 14 regarding the impacts of Rate Decision No. 74364.

Under ASC Topic 980, rate regulated entities defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that these costs and credits will be recognized in the rate making process in a period different from the period in which they would have been reflected in income by an unregulated company. Certain costs associated with our rate cases have been deferred on our balance sheet as regulatory assets as approved by the ACC. At December 31, 2013, we have deferred \$400,000 as a regulatory asset on our balance sheet related to costs incurred in connection with our most recent rate case. This amount will be amortized proportionally to general and administrative expense as the new rates provided by Rate Decision No. 74364 are phased-in.

The Company also has recorded a regulatory liability in the amount of \$11.2 million as of December 31, 2013. The regulatory liability was established in connection with the 2010 Regulatory Rate Decision, and has been presented net against certain intangible assets in our balance sheet (see Note 6).

*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.

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

In addition to third party costs, direct 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 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.

Prior to the sale of GWM, fees pertaining to the FATHOM™ business primarily consisted of recurring fees charged to customers on a monthly basis that had been negotiated as either a set fee per mailing (billing) to the utility customers of our FATHOM™ customer, or a set fee per month based on the number of meters covered under the respective FATHOM™ arrangement. The services provided by GWM for the recurring fees primarily consisted of ongoing customer service, billing, collection, meter reading, data analysis, access to the FATHOM™ systems, and maintenance, although not all FATHOM™ customers had requested the same services. The recurring fees were generally recognized as revenue on a monthly basis provided an arrangement existed, pricing was fixed or determinable, the service to the customer had been provided and collectability was reasonably assured.

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

## GLOBAL WATER RESOURCES, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Prior to the sale of GWM, we evaluated FATHOM<sup>TM</sup> agreements to determine if such agreements constituted multiple-element arrangements that included multiple revenue generating activities. Accounting for arrangements that contain more than a single deliverable generally required 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 was allocated to each of the elements based on the individual element's estimated selling price. Each arrangement required careful analysis to ensure that all of the individual elements in the arrangement were 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 was 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 were not available.

Once the proper amount of revenue for each element was determined, we made an assessment of the appropriate model under which the revenue would be recognized. In making this determination, we considered the nature of services (i.e., consideration of whether the services were 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 that were generated 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 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 purchase these contractual rights from the respective Developer immediately before we complete 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 are 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. The Company did not have any of these transactions during the year ended December 31, 2013.

*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 whereby the GWRI parent company, which owns the operating utilities, provides services to plan, coordinate and finance the water and wastewater infrastructure that would otherwise be required to be performed or subcontracted by the developer or homebuilder.

Under the ICFAs, the GWRI parent company has a contractual obligation to ensure physical capacity exists through its regulated utilities for water and wastewater to the landowner/developer when needed. This obligation persists regardless

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

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 ICFA 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 is amortized as a reduction of depreciation expense over the estimated depreciable life of the utility plant at the related utilities. Refer to Note 14 for additional discussion regarding ICFAs.

*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.

*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 \$35.8 million and \$33.7 million as of December 31, 2013 and 2012, respectively (see Note 9).

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

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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 6).

*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 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 Notes 6 and 14).

*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 \$435,000 and \$353,000 for the years ended December 31, 2013 and 2012, 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



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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 \$64.1 million and \$64.8 million as of December 31, 2013 and 2012, 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 8 for information as to the fair value of our long-term debt. Our refundable AIAC have a carrying value of \$97.3 million and \$100.2 million at December 31, 2013 and 2012, 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 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**

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

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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.

In February 2013, the FASB issued amended guidance to improve the transparency of reporting other comprehensive income reclassifications. This guidance is effective for reporting periods beginning after December 15, 2012. Early adoption is permitted. The Company currently does not have other comprehensive income.

In February 2013, the FASB issued updated guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. GAAP. The guidance requires an entity to measure those obligations as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors. This guidance also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. The amendments in this guidance are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The amendments in this guidance should be applied retrospectively to all prior periods presented for those obligations resulting from joint and several liability arrangements within the guidance's scope that exist at the beginning of an entity's fiscal year of adoption. The Company does not expect a material impact on the Company's financial statements due to the adoption of this guidance.

In July 2013, the FASB issued amended guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, similar tax loss, or tax credit carryforward exists. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows: to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. This guidance applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. The amendments in this guidance are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The Company does not expect a material impact on the Company's financial statements due to the adoption of this guidance.

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**3. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment at December 31, 2013 and December 31, 2012 consist of the following (in thousands of US\$):

	<b>December 31, 2013</b>	<b>December 31, 2012</b>	<b>Average Depreciation Life (in years)</b>
PROPERTY, PLANT AND EQUIPMENT:			
Mains/lines/sewers .....	\$ 137,944	\$ 135,631	47
Plant .....	79,527	78,689	25
Equipment .....	42,617	41,582	10
Meters.....	6,097	5,898	12
Furniture, fixture and leasehold improvements .....	400	1,176	8
Computer and office equipment .....	934	2,729	5
Software .....	158	6,395	3
Land and land rights .....	986	977	
Other.....	139	139	
Construction work-in-process .....	48,517	48,481	
Total property, plant and equipment .....	317,319	321,697	
Less accumulated depreciation.....	(68,309)	(61,461)	
Net property, plant and equipment.....	<u>\$ 249,010</u>	<u>\$ 260,236</u>	

**4. ACCOUNTS RECEIVABLE**

Accounts receivable at December 31, 2013 and December 31, 2012 consist of the following (in thousands of US\$):

	<b>December 31, 2013</b>	<b>December 31, 2012</b>
Billed receivables.....	\$ 1,576	\$ 2,132
Less allowance for doubtful accounts.....	(102)	(206)
Accounts receivable – net .....	<u>\$ 1,474</u>	<u>\$ 1,926</u>



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**5. EQUITY METHOD INVESTMENT AND CONVERTIBLE NOTE**

As discussed in Note 1, in connection with the sale of GWM, the Company made an investment in the FATHOM™ Partnership. This investment is accounted for under the equity method and consisted of the following at December 31, 2013 (in thousands of US\$):

	<b>December 31, 2013</b>
Series A Preferred Units of FATHOM™ Partnership .....	\$ 750
Common Units of FATHOM™ Partnership .....	98
Loss on equity investment .....	(707)
Equity method investment .....	<u>\$ 141</u>

Additionally, GWRI invested \$750,000 in a 10% convertible note of GWM, which matures on December 31, 2014. We have classified the convertible note as available-for-sale since we expect it to be converted prior to maturity. The convertible note will be converted upon a qualified financing of FATHOM™ Partnership or at the discretion of the majority partner of FATHOM™ Partnership, but no later than the date of maturity (qualified financing has been defined as an equity financing by FATHOM™ Partnership in which FATHOM™ Partnership sells its units for at least \$1.75 per unit and the aggregate proceeds from such financing is at least \$15 million, exclusive of convertible note amounts converted). We account for this investment in accordance with relevant accounting guidance for debt and equity securities which requires the fair value measurement of the investment pursuant to ASC Topic 820, *Fair Value Measurement*. We define fair value as the price that would be received from selling an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date.

The fair value of the investment in the convertible notes at initial recognition was determined using the transaction price, of which the price paid by the Company was consistent with the price paid by third party investors for comparable convertible notes. At December 31, 2013, based upon our evaluation of various relevant factors, we do not believe the fair value of the investment in convertible notes has changed since the date of the transaction.

We evaluate our investment in FATHOM™ Partnership/GWM 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. As of December 31, 2013 the losses incurred on the investment were greater than anticipated; however, based upon our evaluation of various relevant factors, including the ability of FATHOM™ to achieve and sustain an earnings capacity that would justify the carrying amount of our investment, as of December 31, 2013 we do not believe there is an impairment.

We have evaluated whether GWM qualifies as a variable interest entity (VIE) pursuant to the accounting guidance of ASC 810, *Consolidations*. Considering the potential that our equity investment in FATHOM™ Partnership/GWM may not be sufficient to absorb the losses of FATHOM™, we believe it is currently appropriate to view GWM as a VIE. However, considering GWRI's minority interest and limited involvement with the FATHOM™ business, the Company would not be required to consolidate the financial statements of GWM. Rather, we have accounted for our investment under the equity method.

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**6. GOODWILL AND INTANGIBLE ASSETS**

The carrying value of goodwill totaled \$13,082,000 at December 31, 2013 and December 31, 2012.

Intangible assets at December 31, 2013 and December 31, 2012 consisted of the following (in thousands of US\$):

	December 31, 2013			December 31, 2012		
	Gross Amount	Accumulated Amortization	Net Amount	Gross Amount	Accumulated Amortization	Net Amount
INDEFINITE LIVED INTANGIBLE ASSETS:						
CP Water CC&N service area.....	\$ 1,532	\$ -	\$ 1,532	\$ 1,532	\$ -	\$ 1,532
Intangible trademark .....	13	-	13	13	-	13
	1,545	-	1,545	1,545	-	1,545
AMORTIZED INTANGIBLE ASSETS:						
Acquired ICFAs .....	17,978	(12,154)	5,824	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)	890	(11,227)	(12,117)	141	(11,976)
	13,267	(13,267)	-	13,267	(13,267)	-
Total intangible assets.....	\$ 14,812	\$ (13,267)	\$ 1,545	\$ 14,812	\$ (13,267)	\$ 1,545

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. Due to the uncertainty of the timing of when cash will be received under ICFA agreements, we cannot reliably estimate when the remaining intangible assets amortization will be recorded (see also Note 14).

**7. 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 \$603,000 and \$542,000 during the year ended December 31, 2013 and 2012, respectively. Also, we have historically obtained legal services from a law firm in which one of our shareholders and directors has an interest. Total legal fees paid to this law firm were \$11,000 and \$29,000 for the years ended December 31, 2013 and 2012, 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 8.

GWR Global Water Resources Corp. ("GWRC") was organized in 2010 and holds an approximate 48.1% interest in the Company. GWRI provides for the ongoing management and general administration of GWRC's business affairs pursuant to a management agreement between GWRC and GWRI to provide such services. Accordingly, GWRC is

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economically dependent on the Company. Services provided by the Company under the management agreement 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. 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. Amounts paid by GWRI on GWRC's behalf during the year ended December 31, 2013 totaled \$286,000, and totaled approximately \$849,000 since GWRC's incorporation in 2010. Prior to 2012, the Company reported the amount paid for GWRC as a receivable from the related party. However, since the Company has not been 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 discussed in Note 1, GWM has historically provided billing, customer service and other support services for the Company's regulated utilities. Amounts collected by GWM from the Company's customers that GWM has not yet remitted to the Company are included within the 'due from related party' caption on the Company's consolidated balance sheet. Notwithstanding the sale of GWM on June 5, 2013, FATHOM™ will continue to provide these services to the Company's regulated utilities under a long-term service agreement. Based on current connections, we estimate that fees to be paid to GWM for FATHOM™ services will be \$7.69 per water account/month, an annual rate of approximately \$2.4 million. Since the sale of GWM, the Company has incurred approximately \$1.3 million of fees for FATHOM™ services as of December 31, 2013.

As of December 31, 2013, there is no outstanding payable due to GWM pursuant to the working capital adjustment of the GWM sale agreement as all such obligations have been paid as of December 31, 2013.

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**8. 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, 2013 and December 31, 2012 are as follows (in thousands of US\$):

	December 31, 2013		December 31, 2012	
	Short-term	Long-term	Short-term	Long-term
<b>BONDS PAYABLE –</b>				
5.450% Series 2006, maturing December 1, 2017 .....	\$ 880	\$ 2,955	\$ 835	\$ 3,835
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	-
6.550% Series 2007, maturing December 1, 2037 – net of unamortized discount of \$379 and \$400 at December 31, 2013 and December 31, 2012, respectively .....	625	51,496	-	52,100
6.375% Series 2008, maturing December 1, 2018 .....	175	820	165	995
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 .....	654	6,154	490	6,808
Variable - LIBOR plus 3.00% Series 2012B, maturing December 1, 2021 .....	546	5,146	410	5,692
	<u>2,880</u>	<u>119,391</u>	<u>2,475</u>	<u>122,250</u>
<b>TERM LOAN –</b>				
LIBOR plus 3.82% Regions Term Loan, maturing December 1, 2021 .....	1,200	9,100	600	10,300
<b>OTHER LOANS –</b>				
8.000% Garcia loan, maturing January 2015 .....	6	1	5	7
Capital lease obligations .....	86	246	123	213
	<u>\$ 4,172</u>	<u>\$ 128,738</u>	<u>\$ 3,203</u>	<u>\$132,770</u>
<b>Total debt .....</b>				

*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 and Santa Cruz. The Company has not granted any deed of trust, mortgage, or other lien on property of Santa Cruz or Palo Verde. These 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. The tax exempt bonds require we maintain a minimum Debt Service Coverage Ratio of 1.10:1.00, tested annually based on the combined operating results of our Santa Cruz and Palo Verde utilities.

*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™. On March 23, 2012, approximately \$4.0 million of the proceeds from the secured term credit facility was used to extinguish the balance of a revolving line of credit maintained by the Company. 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.

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*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 7). Additionally, approximately \$4.0 million of the proceeds was deposited into an escrow account and was used to repay the Water Infrastructure Finance Authority of Arizona loans in full in August 2012.

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 5 year terms) with the Regions Bank. These agreements qualify as derivative instruments and are recorded at fair value. In total, the instruments cost \$72,000. The instruments were revalued at \$61,000 and \$123,000 as of December 31, 2013 and 2012, respectively, with the mark-to-market adjustment recorded 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, resulting in a combined debt service fund balance of approximately \$10,654,000 as of December 31, 2013 and 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 determined that we would fail to meet some of the debt covenant requirements. The Company notified Regions Bank of the potential covenant violations 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

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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 granted Regions Bank a first-priority security interest in the debt service fund) and (v) any proceeds received from Sierra Negra Ranch LLC pursuant to a certain arbitration award (see Note 12) will be deposited into an emergency capital expenditure reserve fund with Regions Bank having a first-priority security interest in the fund. Effective April 1, 2014, the terms of the 2012 Term Loan will revert back to the original terms.

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, our former subsidiary that owns FATHOM<sup>TM</sup>. Under this provision, the Amended 2012 Term Loan requires the Company, exclusive of GWM, to 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.

As of December 31, 2013, the Company was in compliance with its financial debt covenants.

At December 31, 2013, 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
2014 .....	\$ 4,086	\$ 109
2015 .....	4,476	90
2016 .....	4,835	88
2017 .....	4,945	64
2018 .....	5,070	39
Thereafter.....	109,545	-
Subtotal.....	\$ 132,957	\$ 390
Less: amount representing interest .....	-	(58)
Total.....	<u>\$ 132,957</u>	<u>\$ 332</u>

At December 31, 2013, the carrying value of the non-current portion of long-term debt was \$128.7 million, with an estimated fair value of \$138.6 million. The carrying value of the non-current portion of long-term debt was \$132.8 million on December 31, 2012, with an estimated fair value of \$143.9 million. The fair value of our debt was estimated based on interest rates considered available for instruments of similar terms and remaining maturities.

## 9. 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

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will not be realized. The Company routinely considers whether a valuation allowance should be recorded against its deferred tax assets.

The income tax expense (benefit) from continuing operations for the years ended December 31, 2013 and 2012 is comprised of (in thousands of US\$):

	<b>2013</b>	<b>2012</b>
Current income tax expense .....	\$ -	\$ -
Deferred income tax expense .....	16	30,667
Income tax expense .....	<u>\$ 16</u>	<u>\$ 30,667</u>

The income tax expense (benefit) for the years ended December 31, 2013 and 2012 differs from the amount that would be computed using the federal statutory income tax rate due to the following (in thousands of US\$):

	<b>2013</b>	<b>2012</b>
Computed federal tax (benefit) expense at statutory rate .....	\$ (2,048)	\$ (2,657)
State income taxes - net of federal tax benefit .....	(258)	(364)
Valuation allowance <sup>(1)</sup> .....	2,140	33,668
Other — net .....	182	20
Income tax expense (benefit) .....	<u>\$ 16</u>	<u>\$ 30,667</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, 2013, the valuation allowance totaled approximately \$35.8 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.



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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, 2013 and 2012 (in thousands of US\$):

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
DEFERRED TAX ASSETS:		
Taxable meter deposits .....	\$ 708	\$ 668
Net operating loss carry forwards .....	6,147	11,565
Balterra intangible asset acquisition .....	345	349
Deferred gain on Sale of GWM .....	878	-
Contributions in aid of construction .....	24,187	25,065
Intangible assets .....	1,888	2,282
Equity investment loss .....	271	-
Property, plant and equipment .....	767	-
Other .....	617	680
Total deferred tax assets	<u>35,808</u>	<u>40,609</u>
DEFERRED TAX LIABILITIES:		
Property, plant and equipment .....	-	(1,752)
Deferred gain on sale of assets - discontinued operations .....	-	(5,189)
CP Water intangible asset acquisition .....	(589)	(589)
Total deferred tax liabilities .....	(589)	(7,530)
Valuation allowance .....	(35,808)	(33,668)
Net deferred tax asset (liability) .....	<u>\$ (589)</u>	<u>\$ (589)</u>

As of December 31, 2013, we have approximately \$16.2 million in federal and state net operating loss ("NOL") carry forwards available to offset future taxable income, with approximately \$14.4 million expiring in 2029-2033 for the federal return and \$1.8 million expiring in 2014-2033 for the state return (effective for the 2012 tax year, state NOLs for the state of Arizona expire after 20 years).

After the recording of the valuation allowance discussed above, the remaining net deferred tax liability of \$589,000 at December 31, 2013 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.

During 2013, the Company received correspondence from the Internal Revenue Service ("IRS") regarding the deferred income tax gain related to its previously owned entities, Cave Creek Water Company, Inc. ("Cave Creek") and Pacer Equities, Inc. ("Pacer"), which we had acquired in March 2005. Cave Creek provided water utility operations and water distribution to residential and commercial customers in the vicinity of the Town of Cave Creek in Maricopa County, Arizona, and was regulated by the Commission. Pacer owned the water treatment facility utilized by Cave Creek. In 2007, the assets of Cave Creek and Pacer were sold to the Town of Cave Creek to settle a condemnation. Pursuant to the condemnation proceeding in March 2007, the Company agreed to convey the assets of Cave Creek and Pacer to the Town of Cave Creek (the "Town") as a sale and purchase. The total purchase price was \$19.5 million, which along with interest was paid by the Town in two installments in 2007. The condemnation transaction resulted in a pre-tax gain of approximately \$13.2 million. Since 2007, the tax gain had been deferred under Internal Revenue Code Section 1033



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election as it had been expected that the tax gain would either reduce the tax basis of replacement assets acquired or be recognized in taxable income in a future period.

The correspondence from the IRS indicated that the Company's request for an extension of time to find replacement property has been denied and that the Company must now recognize the income in its tax return. Accordingly, during 2013, we amended our previously filed tax return for the year 2007. There was no significant tax payment required since the Company was able to utilize net operating loss deferred tax assets to offset the tax liability resulting from recognizing the tax gain.

**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.

At December 31, 2013 and December 31, 2012, there were options to acquire 431 shares of common stock of GWRI outstanding. The options were all vested and exercisable at December 31, 2013. The stock options have a remaining contractual life of approximately 4.5 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*. The Company remeasured the fair value of the award at the end of each period until the options became fully vested on December 31, 2013.

Due to attrition and the sale of GWM, certain former employees of the Company forfeited their stock options. The number of stock options forfeited totaled 107,186, resulting in stock options of 278,511 outstanding at December 31, 2013. As a result of the forfeitures, approximately \$43,000 of previously recorded stock-based compensation was reversed during the year ended December 31, 2013.

Stock-based compensation expense recorded during the years ended December 31, 2013 and 2012 totaled \$48,000 and \$118,000, 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 tracks the performance of GWRC's shares and gives 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.

On December 30, 2010, 350,000 PSUs were issued to members of management, 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

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anniversary of the award grant date. There is no exercise price attached to PSU awards. As of December 31, 2013, 303,333 of these PSU remain outstanding.

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. As of December 31, 2013, 124,722 of these PSU remain outstanding.

During the first quarter of 2013, 76,592 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 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. As of December 31, 2013, 71,448 of these PSU remain outstanding.

**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 stock appreciation rights plan (the “SAR Plan”) authorizing the directors of the Company to issue stock appreciation rights (“SARs”) to our employees. The value of the SARs 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 SARs were issued to employees below the senior management level, and 101,546 remained outstanding as of December 31, 2013. The SARs vested in equal installments over the four quarters of 2012 and will expire four years after the date of issuance. Holders of SARs may exercise their awards once they have vested. Individuals who voluntarily or involuntarily leave the Company forfeit their rights under the awards.

SARs are accounted for as liability compensatory awards under ASC 710, Compensation – General, rather than as equity awards. The SAR 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.

In the third quarter of 2013, the Company granted 100,000 SARs to a key executive of the Company. These SARs vest ratably over sixteen quarters from the grant date and give the employee the right to receive a cash payment amounting to the difference between C\$2.00 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\$2.00 per share. The exercise price was determined by taking the weighted average share price of the 5 days prior to July 1, 2013.

In the fourth quarter of 2013, the Company granted 100,000 SARs to a newly hired officer of the Company. These SARs vest ratably over sixteen quarters from the grant date and give the employee the right to receive a cash payment amounting to the difference between C\$3.38 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\$3.38 per share. The exercise price was determined by taking the weighted average share price of the 30 days prior to November 14, 2013.

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The Company recorded approximately \$508,000 and \$325,000 of compensation expense related to the PSUs and SARs for the years ended December 31, 2013 and 2012, respectively. Based on GWRC's closing share price on December 31, 2013, deferred compensation expense to be recognized over future periods is estimated for the years ending December 31 as follows (in thousands of US\$):

	PSU	SARs
2014 .....	\$ 549	\$ 47
2015 .....	84	47
2016 .....	-	47
2017 .....	-	25
Total .....	\$ 633	\$ 166

## 11. SUPPLEMENTAL CASH FLOW INFORMATION

The following is supplemental cash flow information for the years ended December 31, 2013 and 2012 (in thousands of US\$):

	2013	2012
Cash paid for interest .....	\$ 8,113	\$ 8,360
Capital expenditures included in accounts payable and accrued liabilities .....	204	1,236
Convertible note received in the sale of GWM .....	750	-
Series A Preferred Units in FATHOM™ Partnership received in the sale of GWM .....	750	-

## 12. COMMITMENTS AND CONTINGENCIES

**Commitments** – Prior to the sale of GWM, we leased certain office space in Arizona under operating leases with terms that expire in February 2016. The operating lease agreements are between GWM and the landlord. Accordingly, effective June 5, 2013, the Company is no longer a party under the lease agreements. Nevertheless, GWRI continues to utilize a portion of the office space covered under lease agreements, and GWRI agreed to reimburse GWM up to approximately \$25,000 per month through December 31, 2013 for the Company's use of the office space. This rate was renegotiated in January 2014. For the 2014 year, the Company will lease office space from GWM for approximately \$5,000 per month. Rent expense arising from the operating leases totaled approximately \$420,000 and \$567,000 for the years ended December 31, 2013 and 2012, 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 for each of the years ended December 31, 2013 and 2012.

See also Note 7 regarding our commitment to provide services to GWRC.

**Contingencies** – *Legal Matters* – *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

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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 were in excess of \$3,700,000 of 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 rescission. 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.

We have been actively pursuing all available means to collect the award from SNR, which filed for Chapter 11 bankruptcy. In July 2013, the Bankruptcy court ruled that SNR must cure their default in order to assume the ICFA, which would require full payment of past due ICFA fees, interest and reimbursement of legal costs by no later than March 21, 2014, stating that such value would be determined by the court at a future date. In October 2013, the Company entered into a settlement agreement with SNR wherein payment terms were set to serve as the basis of SNR's bankruptcy plan of reorganization. Under the plan and settlement agreement that was approved by the court, the Company will receive monies due from SNR totaling \$5,321,000, consisting of \$2,802,000 of past due ICFA fees, \$2,219,000 of interest and \$300,000 of reimbursed litigation costs (\$1,000,000 in interest payments were received in January 2014, and the remainder was received on March 21, 2014).

Separately, on March 18, 2014, SNR and NWP filed an application for rehearing with the ACC regarding Rate Decision No. 74364. The application relates only to the particular issue of whether ICFA funds to be paid in the future will be subject to a Consumer Price Index (CPI) adjustment, which Rate Decision No. 74364 approved. The ACC has twenty (20) days from the date of the application to decide if a rehearing will be granted. The application for rehearing has no impact on the effectiveness of Rate Decision No. 74364, and the Company believes that it is a remote possibility that the ACC will grant a rehearing on the matter.

From time to time, we may become 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 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, 2013, is in a net deficit position.

**GLOBAL WATER RESOURCES, INC.**  
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As of December 31, 2013, GWRI had significant notable near-term cash expenditure obligations. Most significantly, the Company has approximately \$4.0 million of interest payments due June 2014 and approximately \$8.0 million of debt interest and principal payments due December 2014. While specific facts and circumstances could change, we believe that, together with cash on hand, 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. Contributing to the Company's belief in its ability to meet its cash flow needs and covenant requirements going forward are the positive economic benefits resulting from the sale of GWM, the anticipated receipt of the remaining funds from the SNR litigation (see Note 12), and the impact from the successful completion of the Company's most recent rate case (see Note 14).

Receipt of the proceeds from the Sale of the 303 Contracts (See Note 1), as well as inclusion of the associated gain within net income for our calculation of EBITDA, was required as of December 31, 2013 to be in compliance with our Fixed Charge Coverage Ratio covenant discussed in Note 8. Our fixed charge ratio covenant defines EBITDA as net income adjusted for income tax, depreciation, interest expense and amortization.

#### **14. SUBSEQUENT EVENTS**

As discussed in Note 1, on July 11, 2012, we filed rate applications with the ACC for seven of our utilities. In February 2014, the rate case proceedings were completed and the ACC issued Rate Decision No. 74364. The rulings of the decision include, but are not limited to, the following:

- For the Company's utilities, a collective revenue requirement increase of \$4.3 million *based on 2011 test year connections*, phased-in over time, with the first increase in January 2015 as follows:

	<b>Incremental</b>	<b>Cumulative</b>
2015 .....	\$ 1,416	\$ 1,416
2016 .....	1,219	2,635
2017 .....	335	2,970
2018 .....	336	3,306
2019 .....	335	3,641
2020 .....	335	3,976
2021 .....	335	4,311

- Full reversal of the imputation of CIAC associated with funds previously received under ICFA's, as required in the Company's last rate case. The reversal restores rate base or future rate base which we expect will also have a significant impact of restoring shareholder equity on the balance sheet.
- The Company has agreed to not enter into any new ICFA agreements. Existing ICFA's will remain in place, but a portion of future payments to be received under the ICFA's will be considered as hook-up fees, which are accounted for as CIAC once expended on plant.
- A 9.5% return on common equity will be adopted.
- None of the Company's utilities will file another rate application before May 31, 2016. GWRI's subsidiaries, Santa Cruz Water Company and Palo Verde Utilities Company may not file for another rate increase before May 31, 2017.

The Company is currently evaluating the impact of Rate Decision No. 74364, including whether sufficient evidence exists that the Company's net deferred tax assets will be utilized in the future; thus allowing the reversal of the valuation allowance currently recorded (see Note 9). With the exception of the phase-in of new rates to be charged to

**GLOBAL WATER RESOURCES, INC.**  
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our utility customers, we expect that the impact of Rate Decision No. 74364 will be effective for the Company in the first quarter of 2014. We anticipate that the impact of Rate Decision No. 74364, combined with the anticipated effect of reversing the income tax valuation allowance, will result in approximately \$60 million of additional income to be reported in the three months ended March 31, 2014.

Subsequent events have been evaluated up to and including March 25, 2014, which is the date these financial statements were approved by GWRI's board of directors.

\* \* \* \* \*

## Board of Directors

### **Trevor T. Hill**

Chairman of the Board, Co-founder  
Phoenix, Arizona, USA

### **William S. Levine**

Co-founder & Director  
Phoenix, Arizona, USA

### **David Tedesco**

Independent Director  
Scottsdale, Arizona, USA

### **Richard M. Alexander**

Independent Director  
Calgary, Alberta, Canada

### **L. Rita Theil**

Independent Director  
Aurora, Ontario, Canada

### **Cindy M. Bowers**

Director of Global Water  
Resources, Inc. (US entity)  
Scottsdale, Arizona, USA

## Executive Officers

### **Trevor T. Hill**

Chairman

### **Cindy M. Bowers**

Executive Vice President &  
Chief Financial Officer

### **Ron L. Fleming**

President & Chief Operating Officer

### **Mike Liebman**

Senior Vice President, Finance

## Investor Information

### **Ross Marshall**

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## Stock Exchange Listing

### **The Toronto Stock Exchange**

Stock symbol: GWR

### **OTCQX**

Stock symbol: GWGWF

## Transfer Agent & Registrar

### **TMX Equity Transfer Services**

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