Global Water Resources, Inc.
Form 10-Q
August 09, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _______________ to _______________
Commission File Number: 001-37756

Global Water Resources, Inc.
(Exact Name of Registrant as Specified in its Charter)

Delaware	90-0632193
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
21410 N. 19th Avenue #220, Phoenix, AZ	85027
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

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

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

As of August 6, 2018, the registrant had 21,455,593 shares of common stock, $0.01 par value per share, outstanding.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements
GLOBAL WATER RESOURCES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)
(Unaudited)

	June 30, 2018	December 31, 2017
ASSETS		
PROPERTY, PLANT AND EQUIPMENT:		
Property, plant and equipment	287,564	289,051
Less accumulated depreciation	(74,830)	(75,592)
Net property, plant and equipment	212,734	213,459
CURRENT ASSETS:		
Cash and cash equivalents	3,778	5,248
Accounts receivable — net	1,705	1,528
Due from affiliates	404	430
Accrued revenue	2,135	1,759
Prepaid expenses and other current assets	769	700
Total current assets	8,791	9,665
OTHER ASSETS:		
Goodwill	1,743	—
Intangible assets — net	12,772	12,772
Regulatory asset	1,871	1,871
Bond service fund and other restricted cash	484	436
Equity method investment	185	345
Other noncurrent assets	59	20
Total other assets	17,114	15,444
TOTAL ASSETS	238,639	238,568
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	523	321
Accrued expenses	7,482	7,252
Customer and meter deposits	1,374	1,395
Long-term debt and capital leases — current portion	39	8
Total current liabilities	9,418	8,976
NONCURRENT LIABILITIES:		
Long-term debt and capital leases	114,472	114,363
Deferred revenue - ICFA	17,358	19,746
Regulatory liability	8,842	8,463
Advances in aid of construction	63,107	62,725
Contributions in aid of construction — net	4,339	4,425
Deferred income tax liabilities, net	3,966	3,114
Acquisition liability	934	934
Other noncurrent liabilities	615	962
Total noncurrent liabilities	213,633	214,732
Total liabilities	223,051	223,708
Commitments and contingencies (Refer to Note 14)		

SHAREHOLDERS' EQUITY:		
Common stock, $0.01 par value, 60,000,000 shares authorized; 19,756,266 and 19,631,266 shares issued as of June 30, 2018 and December 31, 2017, respectively.	197	196
Treasury Stock, 20,673 and no shares at June 30, 2018 and December 31, 2017, respectively.	—	—
Paid in capital	12,439	14,288
Retained earnings	2,952	376
Total shareholders' equity	15,588	14,860
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	238,639	238,568

See accompanying notes to the condensed consolidated financial statements

GLOBAL WATER RESOURCES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
REVENUES:				
Water services	$3,916	$ 3,897	$7,031	$ 6,682
Wastewater and recycled water services	4,518	4,230	8,815	8,218
Unregulated revenues	2,404	18	2,417	36
Total revenues	10,838	8,145	18,263	14,936
OPERATING EXPENSES:				
Operations and maintenance	1,621	1,451	3,130	2,925
Operations and maintenance - related party	404	365	760	725
General and administrative	2,820	2,809	5,217	5,019
Depreciation	1,889	1,808	3,688	3,454
Total operating expenses	6,734	6,433	12,795	12,123
OPERATING INCOME	4,104	1,712	5,468	2,813
OTHER INCOME (EXPENSE):				
Interest income	8	6	15	10
Interest expense	(1,304)	(1,305)	(2,535)	(2,617)
Other	154	336	477	688
Other - related party	60	(33)	58	181
Total other expense	(1,082)	(996)	(1,985)	(1,738)
INCOME BEFORE INCOME TAXES	3,022	716	3,483	1,075
INCOME TAX EXPENSE	(766)	(291)	(907)	(461)
NET INCOME	$2,256	$ 425	$2,576	$ 614
Basic earnings per common share	$0.11	$ 0.02	$0.13	$ 0.03
Diluted earnings per common share	$0.11	$ 0.02	$0.13	$ 0.03
Dividends declared per common share	$0.07	$ 0.07	$0.14	$ 0.14
Weighted average number of common shares used in the determination of:				
Basic	19,640,295	19,589,782	19,635,805	19,585,548
Diluted	19,683,072	19,646,448	19,676,827	19,633,269

See accompanying notes to the condensed consolidated financial statements

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

	Common Stock Shares	Common Stock	Treasury Stock Shares	Treasury Stock	Paid-in Capital	Retained Earnings	Total Equity
BALANCE - December 31, 2017	19,631,266	$ 196	—	$ —	$ 14,288	$ 376	$ 14,860
Dividend declared $0.14 per share	—	—	—	—	(2,786)	—	(2,786)
Treasury Stock	—	—	(20,673)	—	—	—	—
Stock option exercise	125,000	1	—	—	749	—	750
Stock compensation	—	—	—	—	188	—	188
Net income	—	—	—	—	—	2,576	2,576
BALANCE - June 30, 2018	19,756,266	$ 197	(20,673)	$ —	$ 12,439	$ 2,952	$ 15,588

See accompanying notes to the condensed consolidated financial statements

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

	Six Months Ended June 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$2,576	$614
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred compensation	595	1,082
Depreciation	3,688	3,454
Amortization of deferred debt issuance costs and discounts	22	22
Loss on equity investment	160	5
Other (gains) and losses	(28)	5
Provision for doubtful accounts receivable	(3)	55
Deferred income tax expense	852	396
Changes in assets and liabilities		
Accounts receivable	(53)	(256)
Other current assets	(420)	(771)
Accounts payable and other current liabilities	(148)	(951)
Other noncurrent assets	—	55
Other noncurrent liabilities	(1,942)	(32)
Net cash provided by operating activities	5,299	3,678
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(2,458)	(12,771)
Cash paid for acquisitions, net of cash acquired	(2,620)	—
Deposits of restricted cash, net	(47)	(3)
Other cash flows from investing activities	64	—
Net cash used in investing activities	(5,061)	(12,774)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Dividends paid	(2,786)	(2,655)
Advances in aid of construction	382	270
Proceeds from stock option exercise	750	188
Principal payments under capital lease	(8)	(80)
Loan repayments	(7)	—
Debt issuance costs paid	(39)	—
Net cash used in financing activities	(1,708)	(2,277)
DECREASE IN CASH AND CASH EQUIVALENTS	(1,470)	(11,373)
CASH AND CASH EQUIVALENTS — Beginning of period	5,248	20,498
CASH AND CASH EQUIVALENTS – End of period	$3,778	$9,125

See accompanying notes to the condensed consolidated financial statements

GLOBAL WATER RESOURCES, INC.

Notes to the Condensed Consolidated Financial Statements (Unaudited)

1. BASIS OF PRESENTATION, CORPORATE TRANSACTIONS, SIGNIFICANT ACCOUNTING POLICIES, AND RECENT ACCOUNTING PRONOUNCEMENTS

Basis of Presentation and Principles of Consolidation

The condensed consolidated financial statements of Global Water Resources, Inc. (the “Company”, “GWRI”, “we”, “us”, or “our”) and related disclosures as of June 30, 2018 and for the three and six months ended June 30, 2018 and 2017 are unaudited. The December 31, 2017 condensed consolidated balance sheet data was derived from the Company’s audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (“U.S. GAAP”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These financial statements follow the same accounting policies and methods of their application as the Company’s most recent annual consolidated financial statements. These financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2017. In our opinion, these financial statements include all normal and recurring adjustments necessary for the fair statement of the results for the interim period. The results of operations for the three and six months ended June 30, 2018 are not necessarily indicative of the results to be expected for the full year, due to the seasonality of our business.

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

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

Corporate Transactions

Stipulated Condemnation of the Operations and Assets of Valencia

On July 14, 2015, the Company closed the stipulated condemnation to transfer the operations and assets of Valencia to the City of Buckeye. Terms of the condemnation were agreed upon through a settlement agreement and stipulated final judgment of condemnation wherein the City of Buckeye acquired all the operations and assets of Valencia and assumed operation of the utility upon close. The City of Buckeye paid the Company $55.0 million at close, plus an additional $108,000 in working capital adjustments. The City of Buckeye is obligated to pay the Company a growth premium equal to $3,000 for each new water meter installed within Valencia’s prior service areas in the City of Buckeye, for a 20-year period ending December 31, 2034, subject to a maximum payout of $45.0 million over the term of the agreement.

Sale of Loop 303 Contracts

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

Merger with GWR Global Water Resources Corp. (“GWRC”)

On May 3, 2016, the Company completed the merger of GWRC into GWRI. At the time of the merger, GWRC ceased to exist as a British Columbia corporation and the Company continued as the surviving entity of the merger (the "Reorganization Transaction"). In conjunction with the merger of GWRC into GWRI, the Company recorded an approximate $1.4 million tax liability associated with the transfer of GWRC from Canada to the United States, which liability has since been settled.

Private Letter Ruling

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

Pursuant to Internal Revenue Code §1033, the Company would have been able to defer the gain on condemnation through the end of 2017. On April 18, 2017, the Company filed a request for a one-year extension to defer the gain to the end of 2018, which the IRS approved on August 8, 2017. Following the approval of the extension, the Company has slightly modified the timing of certain planned investments within its capital improvement plan in accordance with Internal Revenue Code §1033. Accordingly, the Company substantially completed these investments in 2017, with some remaining improvements intended to be completed in 2018. As a result of the Private Letter Ruling, the Company increased capital expenditures in 2017 as compared to recent years, and expects corresponding reductions to occur in 2018, 2019, and beyond. As of June 30, 2018, our remaining deferred tax liability relating to the Valencia condemnation was approximately $4.7 million. We plan to file another extension during 2018 which, if approved, will defer the remaining gain to the end of 2019.

Acquisition of Eagletail Water Company

On May 15, 2017, the Company acquired Eagletail Water Company ("Eagletail") via merger. At the time of acquisition, Eagletail, a small water utility located west of metropolitan Phoenix, added approximately 55 active water connections and eight square miles of approved service area to the Company’s existing regional service footprint. Total consideration was approximately $80,000. As part of the transaction, the Company acquired assets of approximately $80,000 and assumed liabilities of approximately $78,000.

Acquisition of Turner Ranches Water and Sanitation Company

On May 30, 2018, the Company acquired Turner Ranches Water and Sanitation Company ("Turner"), a non-potable irrigation water utility in Mesa, Arizona, for total consideration of approximately $2,800,000 in cash. Refer to Note 6 — "Acquisitions" for additional information regarding the Turner acquisition.

ACC Tax Docket

At June 30, 2018 and December 31, 2017, the Company had a regulatory asset and regulatory liability in the amount of $1.9 million and $0.6 million, respectively, related to the Federal Tax Cuts and Jobs Act (the "TCJA") signed into law on December 22, 2017. Under ASC Topic 740, Income Taxes, the tax effects of changes in tax laws must be recognized in the period in which the law is enacted. ASC 740 also requires deferred income tax assets and liabilities to be measured at the enacted tax rate expected to apply when temporary differences are to be realized or settled. Thus, at the date of enactment, the Company’s deferred income taxes were re-measured based upon the new tax rate. For the Company’s regulated entities, substantially all of the change in deferred income taxes is recorded as an offset to either a regulatory asset or liability because the impact of changes in the rates are expected to be recovered from or refunded to customers.

On December 20, 2017, the Arizona Corporation Commission (the “ACC”) opened a docket to address the utility ratemaking implications of the TCJA. The ACC is considering the impact for regulated utilities, as it is expected that certain effects of the TCJA add to rate base and others reduce rate base. Numerous companies, including our regulated utilities, filed comments with the ACC in January 2018. The ACC subsequently approved an order in February 2018 requiring Arizona utilities to apply regulatory accounting treatment, which includes the use of regulatory assets and regulatory liabilities, to address all impacts from the enactment of the TCJA. The order also required certain utilities (including all of our currently operating regulated utilities other than Eagletail and Turner) to have made one of the following three types of filings by April 7, 2018: 1) file an application for a tax expense adjustor mechanism, 2) file an intent to file a rate case within 90 days, or 3) any such other application to address rate making implications of the TCJA.

Accordingly, we filed a proposal for a tax expense adjustor mechanism with the ACC on April 9, 2018, which was subsequently amended through an updated filing with the ACC on July 2, 2018. The updated filing set forth a number of alternative proposals, including that the ACC make no reduction to regulated revenues or, in the alternative, that the ACC approve a phased reduction in regulated revenues. The proposals are in the process of being reviewed by the ACC, and the ACC will issue an order approving, modifying, or rejecting the proposals.

At this point, it is not clear what action the ACC will take regarding the TCJA issues. As a result, we cannot determine the exact effect of the TCJA on currently enacted rates. However, based on currently available information and assuming the same number of total active connections as of December 31, 2017, we estimate that the TCJA, based on currently enacted rates, could adversely impact our revenue by as much as approximately $1.1 million on an annual basis.

On August 3, 2018, the ACC Staff published a recommendation in response to the Company's proposal. We now believe it is more likely than not that the ACC will require a rate reduction, and thus, have recorded a $378,000 reduction to revenue for the three and six months ended June 30, 2018. The reduction reflects the staff proposal on the phase-in of tax reform filed August 3, 2018 using the Company's estimated impacts of tax reform filed on July 2, 2018.

In addition, the ACC Chairman has noted that there may be some unintended consequences related to the tax treatment of contributions in aid of construction (“CIAC”) and advances in aid of construction (“AIAC”). We continue to have discussions with developers, homebuilders, and other utilities regarding the AIAC and CIAC issues related to the TCJA and have also filed comments with the ACC on June 22, 2018 regarding these issues. On August 2, 2018, the ACC Staff recommended the adoption of three alternative methodologies for funding the income tax on AIAC and CIAC: 1) full gross-up of the tax to the contributor; 2) self-payment of the tax by the utility; or 3) a hybrid sharing arrangement where the contributor pays a portion of the tax and the utility pays a portion of the tax.

Significant Accounting Policies

Basic and Diluted Earnings per Common Share

As of June 30, 2018, the Company had 555,500 options outstanding to acquire shares of the Company's common stock. The 150,000 options outstanding from the 2016 option grant provide 42,777 and 41,022 common share equivalents for the three and six months ended June 30, 2018, respectively, which were included within the calculation of diluted earnings per share for the three and six months ended June 30, 2018. The 405,500 options outstanding from the 2017 option grant were not included for the three and six months ended June 30, 2018 dilutive earnings per share calculation, as to do so would be antidilutive. Refer to Note 12 — “Deferred Compensation Awards” for additional information regarding the option grants.

As of June 30, 2017, the 300,000 options outstanding from the 2016 option grant provided 56,666 and 47,721 common share equivalents for the three and six months ended June 30, 2017, respectively, which were included within the calculation of diluted earnings per share for the three and six months ended June 30, 2017 . Refer to Note 12 — “Deferred Compensation Awards” for additional information regarding the option grants.

Goodwill

Goodwill represents the excess purchase price over the fair value of net tangible and identifiable intangible assets acquired through acquisitions. Goodwill is not amortized, it is instead tested for impairment annually, or more often, if circumstances indicate a possible impairment may exist. As required, we evaluate goodwill for impairment annually, and do so during the fourth quarter of each year using balances at November 1, and at an interim date if indications of impairment exist. When testing goodwill for impairment, we may assess qualitative factors, including macroeconomic conditions, industry and market considerations, overall financial performance, and entity specific events to determine whether it is more likely than not that the fair value of a operating and reportable segment is less than its carrying amount.

We utilize internally developed discounted future cash flow models, third-party appraisals, or broker valuations to determine the fair value of the operating and reportable segment. Under the discounted cash flow approach, we utilize various assumptions requiring judgment, including projected future cash flows, discount rates, and capitalization rates. Our estimated future cash flows are based on historical data, internal estimates, and external sources. We then compare the estimated fair value to the carrying value. If the carrying value is in excess of the fair value, an impairment charge is recorded to asset impairments within our consolidated statement of operations in the amount by which the reporting unit's carrying value exceeds its fair value, limited to the carrying value of goodwill. Refer to Note 7 — "Goodwill and Intangible Assets" for additional information about goodwill.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update (“ASU”) 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”), which completes the joint effort between the FASB and International Accounting Standards Board to converge the recognition of revenue between the two boards. The new standard affects any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets not included within other FASB standards. The guiding principal of the new standard is that an entity should recognize revenue in an amount that reflects the consideration to which an entity expects to be entitled for the delivery of goods and services. ASU 2014-09 may be adopted using either of two acceptable methods: (1) retrospective adoption to each prior period presented with the option to elect certain practical expedients; or (2) adoption with the cumulative effect recognized at the date of initial application and providing certain disclosures. To assess at which time revenue should be recognized, an entity should use the following steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation. For public business entities, ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within the reporting period. For private companies, ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2018 and interim reporting periods beginning after December 15, 2019. Earlier application is allowed in certain circumstances. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2019. The Company does not believe this update will have a material effect on the Company’s regulated revenue. The American Institute of Certified Public Accountant's Power and Utility Entities Revenue Recognition Task Force has stated that nonexchange transactions, such as CIAC, are not within the scope of Topic 606, and, therefore, those transactions or events will continue to be recognized in accordance with other topics. Additionally, the Company is assessing the impact of ASU 2014-09 with regard to recognition of revenue received under infrastructure coordination and financing agreements ("ICFAs") in connection with substantial completion of capital improvements that will increase the capacity of Palo Verde's wastewater reclamation facility. The Company is evaluating whether this update will have an impact on the recognition of ICFA revenue, which is recognized historically at the time wastewater capacity is completed to serve the property for which ICFA revenues were received.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”). ASU 2016-02 requires lessees to record a right-of-use asset and corresponding lease obligation for lease arrangements with a term of greater than twelve months. ASU 2016-02 requires additional disclosures about leasing arrangements and requires the use of the modified retrospective method, which will require adjustment to all comparative periods presented in the consolidated financial statements. This guidance will be effective for public companies for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. For all other entities, the guidance is effective for annual periods beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2020. The Company does not expect this update to have a material impact on its consolidated financial statements.

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

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). ASU 2016-15 clarifies and provides specific guidance on eight cash flow classification issues that are not currently addressed by current U.S. GAAP and thereby reduce the current diversity in practice. This guidance is effective for public companies for annual periods beginning after December 15, 2017 and interim periods within those annual periods. For all other entities, the guidance is effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2019. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740) Intra-Entity Transfers of Assets Other Than Inventory (“ASU 2016-16”). ASU 2016-16 instructs entities to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs (compared to current U.S. GAAP which prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party). The guidance is effective for public companies for annual periods beginning after December 15, 2017 and interim periods within those annual periods. For all other entities, the guidance is effective for annual periods beginning after December 15, 2018 and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2019. The guidance is required to be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force) (“ASU 2016-18”). ASU 2016-18 requires amounts generally described as restricted cash and restricted cash equivalents to be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. The guidance is effective for public companies for annual periods beginning after December 15, 2017, and interim periods within those annual periods. For all other entities, the guidance is effective for annual periods beginning after December 15, 2018 and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted, including adoption in an interim period. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2019. The guidance should be applied using a retrospective transition method for each period presented. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business (“ASU 2017-01”). ASU 2017-01 provides a more robust framework to use in determining when a set of assets and activities is a business. Also, the amendments provide more consistency in applying the guidance, reducing the costs of application, and make the definition of a business more operable. The guidance is effective for public companies for annual periods beginning after December 15, 2017, including interim periods within those periods. For all other entities, the guidance is effective for annual periods beginning after December 15, 2018, and interim periods with annual periods beginning after December 15, 2019. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2019. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment ("ASU 2017-04"). ASU 2017-04 eliminates Step 2 from the impairment test which requires entities to determine the implied fair value of goodwill to measure if any impairment charge is necessary. Instead, entities will record impairment charges based on the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. For public companies, the provisions of ASU 2017-04 are to be applied on a retrospective basis and are effective for annual and interim goodwill impairment tests in fiscal years beginning after December 15, 2019, with early adoption permitted. For all other entities, the guidance is effective for annual and interim goodwill impairment tests in fiscal years beginning after December 15, 2021. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2022. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07, Compensation - Stock Compensation (Topic 718) Improvements to Nonemployee Share-Based Payment Accounting (“ASU 2018-07”). ASU 2018-07 simplifies the accounting for share-based payments made to nonemployees so the accounting for such payments is substantially the same as those made to employees. Share based awards to nonemployees will be measured at fair value on the grant date of the awards, entities will need to assess the probability of satisfying performance conditions if any are present, and awards will continue to be classified according to Accounting Standards Codification 718 upon vesting which eliminates the need to reassess classification upon vesting, consistent with awards granted to employees. This guidance will be effective for public companies for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. For all other entities, the amendments in this ASU are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Due to qualifying as an emerging growth company, the Company is required to adopt the ASU on January 1, 2020. Early adoption is permitted. The Company is currently assessing the impact that adopting this new standard will have on its consolidated financial statements.

2. REGULATORY DECISION AND RELATED ACCOUNTING AND POLICY CHANGES

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

In accordance with ASC Topic 980, rates charged to utility customers are intended to recover the costs of the provision of service plus a reasonable return in the same period. Changes to the rates are made through formal rate applications with the ACC, which we have done for all of our operating utilities and which are described below.
On July 9, 2012, we filed formal rate applications with the ACC to adjust the revenue requirements for seven utilities representing a collective rate increase of approximately 28% over 2011 revenue levels. In August 2013, the Company entered into a settlement agreement with ACC Staff, the Residential Utility Consumers Office, the City of Maricopa, and other parties to the rate case. The settlement required approval by the ACC's Commissioners before it could take effect. In February 2014, the rate case proceedings were completed and the ACC issued Rate Decision No. 74364, effectively approving the settlement agreement. The rulings of the decision include, but are not limited to, the following:

- For the Company's utilities, adjusting for the condemnation of the operations and assets of Valencia and sale of Willow Valley Water Co., Inc. ("Willow Valley"), which occurred in 2015 and 2016, respectively, a collective revenue requirement increase of $3.6 million based on 2011 test year service connections, phased-in over time, with the first increase in January 2015 as follows (in thousands):

	Incremental	Cumulative
2015	$ 1,083	$ 1,083
2016	887	1,970
2017	335	2,305
2018	335	2,640
2019	335	2,975
2020	335	3,310
2021	335	3,645

Whereas this phase-in of additional revenues was determined using a 2011 test year, to the extent that the number of active service connections increases from 2011 levels, the additional revenues may be greater than the amounts set forth above. On the other hand, if active connections decrease or we experience declining usage per customer, we may not realize all of the anticipated revenues.

- Full reversal of the imputation of CIAC balances associated with funds previously received under ICFAs, as required in the Company's last rate case. The reversal restored rate base or future rate base and had a significant impact of restoring shareholder equity on the balance sheet.
- The Company has agreed to not enter into any new ICFAs. Existing ICFAs will remain in place, but a portion of future payments to be received under the ICFAs will be considered as hook-up fees, which are accounted for as CIAC once expended on plant.
- A 9.5% return on common equity was adopted.

The following provides additional discussion on accounting and policy changes resulting from Rate Decision No. 74364.
Infrastructure Coordination and Financing Agreements – ICFAs are agreements with developers and homebuilders whereby GWRI, the indirect parent of the operating utilities, provides services to plan, coordinate, and finance the water and wastewater infrastructure that would otherwise be required to be performed or subcontracted by the developer or homebuilder.
Under the ICFAs, GWRI has a contractual obligation to ensure physical capacity exists through its regulated utilities for water and wastewater to the landowner/developer when needed. This obligation persists regardless of connection growth. Fees for these services are typically a negotiated amount per equivalent dwelling unit for the specified development or portion of land. Payments are generally due in installments, with a portion due upon signing of the agreement, a portion due upon completion of certain milestones, and the final payment due upon final plat approval or sale of the subdivision. The payments are non-refundable. The agreements are generally recorded against the land and must be assumed in the event of a sale or transfer of the land. The regional planning and coordination of the infrastructure in the various service areas has been an important part of GWRI's business model.
Prior to January 1, 2010, GWRI accounted for funds received under ICFAs as revenue once the obligations specified in the ICFA were met. As these arrangements are with developers and not with the end water or wastewater customer,

the timing of revenue recognition coincided with the completion of GWRI's performance obligations under the agreement with the developer and with GWRI's ability to provide fitted capacity for water and wastewater service through its regulated subsidiaries.

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

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

The Company will account for the portion allocated to the HUF as a CIAC contribution. However, in accordance with the ACC directives the CIAC is not deducted from rate base until the HUF funds are expended for utility plant. Such funds will be segregated in a separate bank account and used for plant. A HUF liability will be established and will be amortized as a reduction of depreciation expense over the useful life of the related plant once the HUF funds are utilized for the construction of plant. For facilities required under a HUF or ICFA, the utilities must first use the HUF moneys received, after which, it may use debt or equity financing for the remainder of construction. The Company will record 30% of the funds received, up until the HUF liability is fully funded, as deferred revenue, which is to be recognized as revenue once the obligations specified within the ICFA are met, including construction of sufficient operating capacity to serve the customers for which revenue was deferred. As of June 30, 2018 and December 31, 2017, ICFA deferred revenue recorded on the consolidated balance sheet totaled $17.4 million and $19.7 million, respectively, which represents deferred revenue recorded for ICFA funds received on contracts that had become due prior to Rate Decision No. 74364. For ICFA contracts coming due after December 31, 2013, as funding is received 30% will be added to this balance with the remaining 70% recorded to a HUF liability, until the HUF liability is fully funded at which time any funding greater than the HUF liability will be recorded as deferred revenue.

ICFA Revenue Recognition - The Company will recognize ICFA revenue when the following conditions are met:

- the fee is fixed and determinable;
- the cash received is nonrefundable;
- capacity currently exists to serve the specific lots; and
- there are no additional significant performance obligations.

As of June 30, 2018, the Company recognized $2.4 million of ICFA revenue which resulted from additional capacity added to a wastewater plant.

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

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

As a result of Rate Decision No. 74364, the Company changed its policy around the ICFA related intangible assets. As discussed above, pursuant to Rate Decision No. 74364, approximately 70% of ICFA funds to be received in the future will be recorded as a HUF, until the HUF is fully funded at the Company's applicable utility subsidiary. The remaining approximate 30% of future ICFA funds will be recorded at the parent company level and will be subject to the Company's ICFA revenue recognition accounting policy. As the Company now expects to experience an economic benefit from the approximately 30% portion of future ICFA funds, 30% of the regulatory liability, or $3.4 million, was reversed in 2014. The remaining 70% of the regulatory liability, or $7.9 million, will continue to be recorded on the balance sheet.

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

3. PROPERTY, PLANT AND EQUIPMENT

Property, plant, and equipment at June 30, 2018 and December 31, 2017 consist of the following (in thousands):

	June 30, 2018	December 31, 2017	Average Depreciation Life (in years)
Mains/lines/sewers	$119,366	$117,381	47
Plant	76,192	72,863	25
Equipment	30,544	29,904	10
Meters	13,005	12,693	12
Furniture, fixture and leasehold improvements	371	368	8
Computer and office equipment	603	720	5
Software	241	242	3
Land and land rights	891	861	
Other	428	428	
Construction work-in-process	45,923	53,591	
Total property, plant and equipment	287,564	289,051	
Less accumulated depreciation	(74,830)	(75,592)	
Net property, plant and equipment	$212,734	$213,459	

4. ACCOUNTS RECEIVABLE

Accounts receivable as of June 30, 2018 and December 31, 2017 consist of the following (in thousands):

	June 30, 2018	December 31, 2017
Billed receivables	$1,820	$ 1,691
Less allowance for doubtful accounts	(115)	(163)
Accounts receivable – net	$1,705	$ 1,528

5. EQUITY METHOD INVESTMENT

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

In March 2017, FATHOM™ completed a round of financing, wherein our ownership percentage was reduced from 8.0% to 7.1% on a fully diluted basis. In conjunction with the recapitalization, the Company's equity interest was adjusted in accordance with ASC 323, Investments-Equity Method and Joint Ventures, wherein we recorded a $243,000 gain for the six months ended June 30, 2017. The adjustment to the carrying value of the FATHOM™ investment was calculated using our proportionate share of FATHOM™'s adjusted net equity. The gain was recorded within other income and expense in our consolidated statement of operations in the first quarter of 2017. The carrying value of the FATHOM™

investment consisted of a balance of $185,000 as of June 30, 2018 and $345,000 as of December 31, 2017, and reflects our initial investment, the adjustments related to subsequent rounds of financing, and our proportionate share of FATHOM™'s cumulative earnings (losses).

We evaluate the FATHOM™ investment for impairment whenever events or changes in circumstances indicate that the carrying value of the FATHOM™ investment may have experienced an “other-than-temporary” decline in value. Since the sale of GWM, the losses incurred on the FATHOM™ investment were greater than anticipated; however, based upon our evaluation of various relevant factors, including the most recent round of financing and the ability of FATHOM™ to achieve and sustain an earnings capacity that would justify the carrying amount of the FATHOM™ investment, we do not believe the FATHOM™ investment to be impaired as of June 30, 2018.

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

6. ACQUISITIONS

Acquisition of Turner

On May 30, 2018, the Company acquired all of the equity of Turner, a non-potable irrigation water utility in Mesa, Arizona, for total consideration of $2.8 million. This acquisition is consistent with the Company's declared strategy of making accretive acquisitions. At the time of acquisition, Turner had 963 residential irrigation connections and approximately seven square miles of service area. The acquisition was accounted for as a business combination under ASC Topic 805, "Business Combinations." The purchase price was allocated to the acquired utility assets and liabilities assumed based on the seller's book value at acquisition as the historical cost of these assets and liabilities will be the amounts that will continue to be reflected in customer rates.

A preliminary purchase price allocation of the net assets acquired in the transaction is as follows (in thousands):

Net assets acquired:	
Cash	$176
Accounts receivable	121
Gross property, plant and equipment	4,495
Construction work-in-progress	92
Accumulated depreciation	(3,751)
Accounts payable	(30)
Accrued expenses	(46)
Total net assets assumed	1,057
Goodwill	1,743
Total purchase price	$2,800

The revenue recognized post acquisition and the pro forma effect of the business acquired is not material to the company's financial position or results of operations.

7. GOODWILL AND INTANGIBLE ASSETS

Goodwill

As of June 30, 2018, the goodwill balance of $1.7 million related to the Turner acquisition. There were no indicators of impairment identified as a result of the Company's review of events and circumstances related to its goodwill subsequent to the acquisition. Refer to Note 6 — "Acquisitions" for additional information regarding the Turner acquisition.

Intangible Assets

As of June 30, 2018 and December 31, 2017 intangible assets consisted of the following (in thousands):

	June 30, 2018			December 31, 2017		
	Gross Amount	Accumulated Amortization	Net Amount	Gross Amount	Accumulated Amortization	Net Amount
INDEFINITE LIVED INTANGIBLE ASSETS:						
CP Water Certificate of Convenience & Necessity service area	$1,532	$ —	$1,532	$1,532	$ —	$1,532
Intangible trademark	13	—	13	13	—	13
	1,545	—	1,545	1,545	—	1,545
AMORTIZED INTANGIBLE ASSETS:						
Acquired ICFAs	17,978	(12,154)	5,824	17,978	(12,154)	5,824
Sonoran contract rights	7,406	(2,003)	5,403	7,406	(2,003)	5,403
	25,384	(14,157)	11,227	25,384	(14,157)	11,227
Total intangible assets	$26,929	$ (14,157)	$12,772	$26,929	$ (14,157)	$12,772

Acquired ICFAs and contract rights related to our 2005 acquisition of Sonoran Utility Services, LLC assets are amortized when cash is received in proportion to the amount of total cash expected to be received under the underlying agreements. Due to the uncertainty of the timing of when cash will be received under ICFA agreements and contract rights, we cannot reliably estimate when the remaining intangible assets' amortization will be recorded. No amortization was recorded for these balances for the three and six months ended June 30, 2018 and 2017.

8. TRANSACTIONS WITH RELATED PARTIES

The Company provides 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 $149,000 and $14,000 for the three months ended June 30, 2018 and 2017, respectively. Medical claims paid to the plan were approximately $211,000 and $104,000 for the six months ended June 30, 2018 and 2017, respectively.

As GWM was previously owned by the Company, it has historically provided billing, customer service, and other support services for the Company's regulated utilities pursuant to a services agreement with GWM whereby the Company has agreed to use the FATHOM™ platform for all of its regulated utility services for an initial term of 10 years. The services agreement was amended on November 17, 2016, which extended the term of the contract through December 31, 2026. As part of the amended agreement, the Company reduced the monthly rate per connection from $7.79 per water account/month to $6.24 per water account/month. Additionally, the scope of services was expanded to include a meter replacement program of approximately $11.4 million, wherein the Company replaced a majority of its meter infrastructure. As of June 30, 2018, $10.7 million has been paid to GWM in connection with the meter exchange program. Amounts collected by GWM from the Company's customers that GWM has not yet remitted to the Company are included within the "Due from affiliates" caption on the Company's consolidated balance sheet. As of June 30, 2018 and December 31, 2017, the unremitted balance totaled $404,000 and $430,000, respectively. Based on current service connections, annual fees to be paid to GWM for FATHOM™ services will be approximately $1.5 million at a rate of $6.24 per water account/month. For the three months ended June 30, 2018 and 2017, the Company incurred FATHOM™ service fees of approximately $404,000 and $365,000. For the six months ended June 30, 2018 and 2017, the Company incurred FATHOM™ service fees of approximately $760,000 and $725,000, respectively.

In addition, the Company entered into a services agreement with GWM whereby the Company has agreed to use the FATHOM™ platform for all of its regulated utility services for an initial term of 10 years. The services agreement was amended on November 17, 2016, which extended the term of the contract through December 31, 2026. As part of the amended agreement, the Company reduced the monthly rate per connection from $7.79 per water account/month to $6.24 per water account/month. Additionally, the scope of services was expanded to include a meter replacement program of approximately $11.4 million, wherein the Company replaced a majority of its meter infrastructure. As of June 30, 2018, $10.7 million has been paid to GWM in connection with the meter exchange program.

The services agreement is automatically renewable for successive 10-year periods, unless notice of termination is given prior to any renewal period. The services agreement may be terminated by either party for default only and the termination of the services agreement will also result in the termination of the royalty payments (described below) payable to the Company. Pursuant to the purchase agreement for the sale of GWM, the Company is entitled to quarterly royalty payments based on a percentage of certain of GWM's recurring revenues for a 10-year period, up to a maximum of $15.0 million. The Company made the election to record these quarterly royalty payments prospectively in income as the amounts are earned. Royalties recorded within other income totaled approximately $109,000 and $95,000 for the three months ended June 30, 2018 and 2017, respectively, and $217,000 and $187,000 for the six months ended June 30, 2018 and 2017, respectively.

9. ACCRUED EXPENSES

Accrued expenses at June 30, 2018 and December 31, 2017 consist of the following (in thousands):

	June 30, 2018	December 31, 2017
Deferred compensation	$2,048	$ 2,171
Property taxes	1,047	989
Meter replacement - related party	717	717
Interest	463	468
Dividend payable	466	464
Asset retirement obligation	427	427
Deferred phantom units eligible for exercise	448	—
Other accrued liabilities	1,866	2,016
Total accrued expenses	$7,482	$ 7,252

10. DEBT

The outstanding balances and maturity dates for short-term (including the current portion of long-term debt) and long-term debt as of June 30, 2018 and December 31, 2017 are as follows (in thousands):

	June 30, 2018		December 31, 2017	
	Short-term	Long-term	Short-term	Long-term
BONDS AND NOTES PAYABLE -				
4.380% Series A 2016, maturing June 2028	$—	$28,750	$—	$28,750
4.580% Series B 2016, maturing June 2036	—	86,250	—	86,250
1.200% WIFA Loan, maturing October 2032	3	40	3	41
4.650% Harquahala Loan, maturing January 2021	5	12	5	15
	8	115,052	8	115,056
OTHER				
Capital lease obligations	31	92	—	—
Debt issuance costs		(672)	—	(693)
Total debt	$39	$114,472	$8	$114,363

2016 Senior Secured Notes

On June 24, 2016, the Company issued two series of senior secured notes with an aggregate total principal balance of $115.0 million at a blended interest rate of 4.55%. Series A carries a principal balance of $28.8 million and bears an interest rate of 4.38% over a twelve-year term, with the principal payment due on June 15, 2028. Series B carries a principal balance of $86.3 million and bears an interest rate of 4.58% over a 20-year term. Series B is interest only for the first five years, with $1.9 million principal payments paid semiannually thereafter. The proceeds of the senior secured notes were primarily used to refinance the previously outstanding long-term tax exempt bonds, which were subject to an early redemption option at 103%, plus accrued interest, as a result of the initial public offering of our common stock in May 2016 (the "U.S. IPO"). As part of the refinancing of the long-term debt, the Company paid a prepayment penalty of $3.2 million and wrote off the remaining $2.2 million in capitalized loan fees related to the tax exempt bonds, which were recorded as additional interest expense in the second quarter of 2016. The senior secured notes are collateralized by a security interest in the Company’s equity interest in its subsidiaries, including all payments representing profits and qualifying distributions. Debt issuance costs as of June 30, 2018 and December 31, 2017 were $672,000 and $693,000, respectively.

The senior secured notes require the Company maintain a debt service coverage ratio of consolidated EBITDA to consolidated debt service of at least 1.10 to 1.00. Consolidated EBITDA is calculated as net income plus depreciation, taxes, interest and other non-cash charges net of non-cash income. Consolidated debt service is calculated as interest expense, principal payments, and dividend or stock repurchases. The senior secured notes also contain a provision limiting the payment of dividends if the Company falls below a debt service ratio of 1.25. However, for the quarter ending June 30, 2021 through the quarter ending March 31, 2024, the ratio drops to 1.20. As of June 30, 2018, the Company was in compliance with its financial debt covenants.

Eagletail Loans

In May 2017, the Company acquired Eagletail. As part of the acquisition, the Company assumed two unsecured loans held by Eagletail. These loans are payable to the Water Infrastructure Finance Authority of Arizona ("WIFA") and Harquahala Valley Community Benefits Foundation ("Harquahala"). Refer to the table above for carrying balances as of June 30, 2018. The WIFA loan bears an interest rate of 1.20% over a 20-year term, while the Harquahala loan bears an interest rate of 4.65% over a 15-year term.

Revolving Credit Line

On April 20, 2018, the Company entered into an agreement with MidFirst Bank, a federally chartered savings association, for a two-year revolving line of credit up to $8.0 million, set to expire on April 30, 2020. The credit facility bears an interest rate of LIBOR plus 2.25%. As of June 30, 2018, the Company had no outstanding borrowings under this credit line. Debt issuance costs as of June 30, 2018 and December 31, 2017 were $137,000 and $20,000, respectively.

The revolving credit line requires the Company maintain a debt service coverage ratio of consolidated EBITDA to consolidated debt service of at least 1.10 to 1.00. The revolving credit line also contains a provision limiting the payment of dividends if the Company falls below a debt service ratio of 1.25. As of June 30, 2018, the Company was in compliance with its financial debt covenant.

At June 30, 2018, the remaining aggregate annual maturities of debt and minimum lease payments under capital lease obligations for the years ended December 31 are as follows (in thousands):

	Debt	Capital Lease Obligations
Remaining six months of 2018	$4	$ 19
2019	8	37
2020	9	37
2021	1,922	37
2022	3,836	8
Thereafter	109,281	—
Subtotal	115,060	138

Less: amount representing interest	—	(16)
Total	$115,060	$ 122

At June 30, 2018, the outstanding principal value of the non-current portion of long-term debt was $115.1 million, with an estimated fair value of $111.3 million. At December 31, 2017, the carrying value of the non-current portion of long-term debt was $115.1

million, with an estimated fair value of $115.7 million. The fair value of our debt was estimated based on interest rates considered available for instruments of similar terms and remaining maturities.

11. INCOME TAXES

During the three months ended June 30, 2018, the Company recorded a tax expense of $766,000 on a pre-tax income of $3.0 million, compared to a tax expense of $291,000 on a pre-tax income of $716,000 for the three months ended June 30, 2017. During the six months ended June 30, 2018, the Company recorded a tax expense of $907,000 on pre-tax income of $3.5 million, compared to a tax expense of $461,000 on pre-tax income of $1.1 million for the six months ended June 30, 2017. The income tax provision was computed based on the Company's estimated effective tax rate, reflective of the TCJA new federal rates beginning January 1, 2018, and forecasted income expected for the full year, including the impact of any unusual, infrequent, or non-recurring items.

12. 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.

2016 stock option grant

In May 2016, GWRI's Board of Directors granted stock options to acquire 325,000 shares of GWRI's common stock to the members of the board. The options were granted with an exercise price of $7.50, the market price of the Company's common shares on the NASDAQ Global Market at the close of business on May 20, 2016. The options vested over a two-year period, with 50% having vested in May 2017 and 50% having vested in May 2018. The options have a three-year life. The Company expensed the $348,000 fair value of the stock option grant ratably over the two-year vesting period in accordance with ASC 323. Stock-based compensation expense of $24,000 and $43,000 was recorded for the three months ended June 30, 2018 and 2017, respectively, and $68,000 and $87,000 was recorded for the six months ended June 30, 2018 and 2017, respectively. As of June 30, 2018, 175,000 options have been exercised with 150,000 outstanding. Of the 175,000 options exercised, 25,000 shares were exercised utilizing a cashless exercise, which resulted in an increase in shares outstanding of 4,327 and a cash equivalent of 20,673 shares recorded to treasury stock.

2017 stock option grant

In August 2017, GWRI's Board of Directors granted stock options to acquire 465,000 shares of GWRI's common stock to employees throughout the Company. The options were granted with an exercise price of $9.40, the market price of the Company's common shares on the NASDAQ Global Market at the close of business on August 10, 2017. The options vest over a four-year period, with 25% vesting in August 2018, 25% vesting in August 2019, 25% vesting in August 2020, and 25% vesting in August 2021. The options have a 10-year life. The Company will expense the $1.1 million fair value of the stock option grant ratably over the four-year vesting period in accordance with ASC 323. Stock-based compensation expense of $67,000 was recorded for the three months ended June 30, 2018 and $121,000 was recorded for the six months ended June 30, 2018. As of June 30, 2018, 54,900 options have been forfeited with 405,500 outstanding.

Phantom stock compensation

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

PSUs are accounted for as liability compensatory awards under ASC 710, Compensation – General, rather than as equity awards. PSU awards are remeasured each period and a liability is recorded equal to GRWI's closing share price as of the balance sheet date multiplied by the number of units vested and outstanding. The value of the benefits is recorded as an expense in the Company's financial statements over the related vesting period. Vesting occurs ratably over 12 consecutive quarters beginning in the period granted. The following table details total awards granted and the number of units outstanding as of June 30, 2018 along with the amounts paid to holders of the PSUs for the three and six months ended June 30, 2018 and 2017 (in thousands, except unit amounts):

			Amounts Paid For the Three Months Ended June 30,		Amounts Paid For the Six Months Ended June 30,	
Grant Date	Units Granted	Units Outstanding	2018	2017	2018	2017
Q1 2014	8,775	—	$—	$—	$—	$3
Q1 2015	28,828	—	—	21	22	43
Q1 2016	34,830	8,708	26	25	53	52
Q1 2017	22,712	13,249	17	16	34	16
Q1 2018	30,907	28,331	23	—	23	—
Total	126,052	50,288	$66	$62	$132	$114

Stock appreciation rights compensation

Beginning January 2012, in an effort to reward employees for their performance, the Company adopted a stock appreciation rights plan authorizing the directors of the Company to issue stock appreciation rights ("SARs") to our employees. Following the consummation of the Reorganization Transaction, the value of the SARs issued under the plan track the performance of GWRI's shares. Each holder has the right to receive a cash payment amounting to the difference between the exercise price and the closing price of GWRI's common shares on the exercise date, provided that the closing price is in excess of the exercise price. Holders of SARs may exercise their awards once vested. Individuals who voluntarily or involuntarily leave the Company forfeit their rights under the awards.

The following table details the recipients of the SARs awards, the grant date, units granted, exercise price, outstanding shares as of June 30, 2018 and amounts paid during the three and six months ended June 30, 2018 and 2017 (in thousands, except unit and per unit amounts):

					Amounts Paid For the Three Months Ended June 30,		Amounts Paid For the Six Months Ended June 30,	
Recipients	Grant Date	Units Granted	Exercise Price	Units Outstanding	2018	2017	2018	2017
Key Executive (1)(3)	Q3 2013	100,000	$ 1.59	—	$—	$185	$166	$366
Key Executive (1)(4)	Q4 2013	100,000	$ 2.69	—	—	158	183	312
Members of Management (1)(5)	Q1 2015	299,000	$ 4.26	183,000	—	—	—	—
Key Executives (2)(6)	Q2 2015	300,000	$ 5.13	300,000	—	—	—	—
Members of Management (1)(7)	Q3 2017	103,000	$ 9.40	103,000	—	—	—	—
Members of Management (1)(8)	Q1 2018	33,000	$ 8.99	33,000	—	—	—	—
Total		935,000		619,000	$—	$343	$349	$678

(1) The SARs vest ratably over sixteen quarters from the grant date.

(2) The SARs vest over sixteen quarters, vesting 20% per year for the first three years, with the remainder, 40%, vesting in year four.

(3) The exercise price was determined by taking the weighted average GWRC share price of the five days prior to the grant date of July 1, 2013.

(4) The exercise price was determined by taking the weighted average GWRC share price of the 30 days prior to the grant date of November 14, 2013.

(5) The exercise price was determined to be the fair market value of one share of GWRC stock on the grant date of February 11, 2015.

(6) The exercise price was determined to be the fair market value of one share of GWRC stock on the grant date of May 8, 2015.