



Global Water Resources (GWRS)

Updated May 7th, 2023 by Nikolaos Sismanis

Key Metrics

| | | | | | |
|-----------------------------|---------|--|---------|----------------------------------|-----------|
| Current Price: | \$10.95 | 5 Year CAGR Estimate: | 2.3% | Market Cap: | \$261.4 M |
| Fair Value Price: | \$8.00 | 5 Year Growth Estimate: | 6.0% | Ex-Dividend Date: | 05/16/23 |
| % Fair Value: | 137% | 5 Year Valuation Multiple Estimate: | -6.1% | Payment Date: | 05/31/23 |
| Dividend Yield: | 2.7% | 5 Year Price Target | \$10.71 | Years Of Dividend Growth: | 8 |
| Dividend Risk Score: | F | Retirement Suitability Score: | F | Rating | Sell |

Overview & Current Events

Global Water Resources is a water resource management company that owns, operates, and manages regulated water, wastewater, and recycled water utilities primarily in metropolitan Phoenix, Arizona. The \$291.2 million market-cap company serves more than 74,000 people in 29,000 homes. Global Water generates around \$45 million in annual revenues and pays its dividends on a monthly basis.

On May 3rd, 2023, Global Water reported its Q1 results for the period ending March 31st, 2023. For the quarter, revenues increased by 30.9% year-over-year to \$13.1 million. Specifically, growth was driven by an 8.7% increase in active service connections and higher rates. The increase in active service connections was primarily due to organic growth and new connections associated with the acquisition of Farmers Water and organic growth in connections.

EPS came in at \$0.10, up from \$0.04 last year. These increases were due to economies of scale improving margins following the company's ongoing expansion. Global Water continues to tap into the fragmented State of Arizona, which is currently amongst the U.S.'s fastest homeownership growth states – hence the consistent organic growth. The company also continues to pursue accretive acquisitions with consolidation benefits and expects continuous growth in connections and rates.

Growth on a Per-Share Basis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|---------------------------|------|------|------|----------|--------|---------|---------|---------|---------|---------|---------------|---------------|
| EPS | --- | --- | --- | (\$0.13) | \$0.23 | \$0.15 | \$0.10 | \$0.05 | \$0.16 | \$0.24 | \$0.40 | \$0.54 |
| DPS | --- | --- | --- | \$0.260 | \$0.27 | \$0.277 | \$0.288 | \$0.288 | \$0.292 | \$0.295 | \$0.30 | \$0.33 |
| Shares¹ | --- | --- | --- | 19.1 | 19.6 | 20.5 | 21.5 | 22.5 | 22.6 | 23.2 | 24.0 | 27.0 |

Global Water has many tailwinds including considerable growth in its recycled water deliveries (6% growth YoY in Q1), notable rate increases, and strong population growth in Phoenix (10.4% over the past decade). As such, we expect EPS to expand massively when expansionary investments slow down. To reflect the stock's actual EPS potential, effectively excluding its current capital-intensive investments, we have used underlying earnings power of \$0.40, growing by a rate of 6% annually through 2028. Note that this is a 'potential' figure, rather than something that's likely to materialize this year. Wall Street consensus EPS estimate for the year is \$0.31.

In terms of its dividend, the company uses a complex financing strategy. Since the underlying net income does not cover dividends, management had been consistently issuing shares and using the proceeds to pay the monthly dividend. In a sense, the monthly dividend plays the role of interest paid to shareholders for "lending" their funds to the company. While this strategy would not be sustainable in the long-term, the company expects to see significant EPS growth over the next few years, as its growth eventually matures and net income catches up to the dividends paid. Management has been growing the dividend annually by fractions (0.8% most recently) as a token to shareholders for their patience as the company drains its margins in order to grow. Consequently, we expect DPS to continue growing by no more than 2%

¹ Share count is in millions.

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annually in the medium-term. Not only can Global Water not afford it, but to issue additional shares at a faster rate would be arguably too dangerous to pull-off under its already quite complex financing strategy.

Valuation Analysis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | Now | 2028 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | 27.4 | 20.0 |
| Avg. Yld. | --- | --- | --- | 1.3% | 2.8% | 2.8% | 2.7% | 1.9% | 1.6% | 1.9% | 2.7% | 3.1% |

The company's past P/E ratios are not meaningful due to management's strategy mentioned above. The stock is currently trading at a P/E of 27.4 based on our speculative earnings power. Shares appear way more expensive based on reported earnings. We lower our fair P/E from 24 to 20. The steep plunge is to reflect mid-single-digit EPS growth prospects, as well as the rise in interest rates. Investors appear to appreciate the secured cash flows that come from water being an essential utility and the regulatory rate increases, but we still find the stock very expensive. Shares offer a dividend yield of around 2.7%, which remains rather underwhelming despite the recent correction in the stock price.

Safety, Quality, Competitive Advantage, & Recession Resiliency

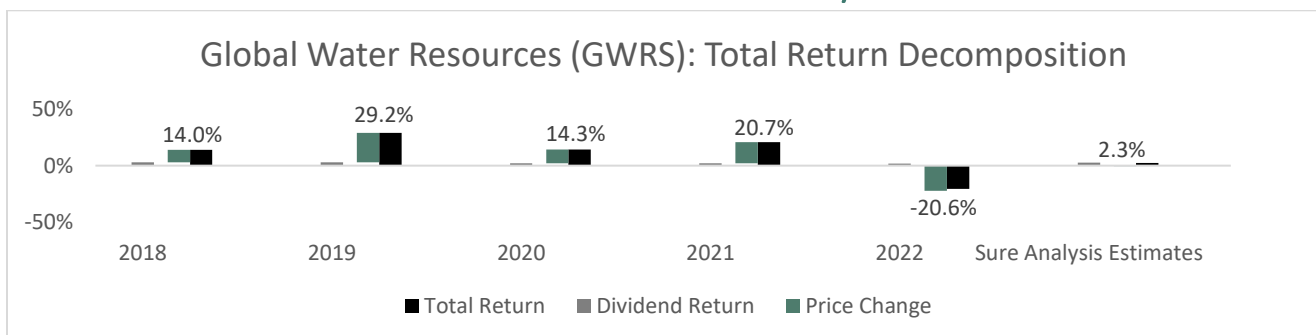
| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | --- | --- | --- | --- | 117% | 185% | 288% | 576% | 182% | 123% | 74% | 61% |

To claim that Global Water's dividends are safe would be reckless. Management is leveraging its business's highly-secure cash flows to make this work, and while it is currently working, payout safety is largely speculative. The company's strategy of issuing shares in order to pay dividends is not exactly a textbook financing case. Still, the company is growing in one of the most attractive cities, benefiting from robust organic growth and the industry's stability. We believe that the company is subject to minor operational risks and should continue expanding. Its history as a trading company is not that long, however cash flows should remain robust even under a heavy recession. Further, the company should not face significant competition going forward, as water provision is a regulated capital-intensive business.

Final Thoughts & Recommendation

Global Water is a truly unique case. The company is benefiting from several catalysts, including organic growth, amid operating in one of the U.S.'s fastest-growing areas. Consequently, the company is able to request above-average rate increases while enjoying robust cash flows due to its business model. However, management's capital allocation strategy may be too exotic for some investors. Since our expected EPS forecast is quite speculative, our expected returns remain quite speculative as well. As more quarters pass by, our estimates should grow more accurate. In any case, we are currently estimating there are limited gains to be made over the next few years as investors likely continue to overvalue the company. Our case has held true since initiating coverage of the stock, which we continue to rate a sell.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|------------------|------|--------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | --- | 33 | 32 | 30 | 31 | 36 | 35 | 38.6 | 41.9 | 45 |
| Gross Profit | --- | 22 | 23 | 22 | 24 | 27 | 27 | 29.1 | 31.6 | 34 |
| Gross Margin | --- | 68.0% | 71.0% | 73.0% | 75.8% | 76.8% | 74.9% | 75.4% | 75.4% | 75.6% |
| SG&A Exp. | --- | 9 | 8 | 10 | 9 | 11 | 11 | 12.7 | 15.2 | 16 |
| D&A Exp. | --- | 9 | 8 | 6 | 7 | 7 | 8 | 9 | 9.5 | 10 |
| Operating Profit | --- | 55 | 7 | 6 | 7 | 9 | 7 | 7.3 | 7 | 8 |
| Operating Margin | --- | 168.3% | 20.4% | 19.5% | 23.5% | 26.1% | 19.6% | 18.9% | 16.7% | 17.8% |
| Net Profit | --- | 65 | 21 | (3) | 5 | 3 | 2 | 1.1 | 3.6 | 5.5 |
| Net Margin | --- | 199.4% | 66.9% | -8.4% | 14.6% | 8.7% | 6.3% | 2.8% | 8.6% | 12.2% |
| Free Cash Flow | --- | 10 | 1 | (7) | (10) | 7 | 0 | 5.4 | 2.1 | (11) |
| Income Tax | --- | (17) | 21 | (1) | (1) | 2 | 1 | 0.8 | 1.2 | 1 |

Balance Sheet Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|----------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets | --- | 308 | 236 | 239 | 239 | 262 | 266 | 283 | 294 | 323 |
| Cash & Equivalents | --- | 7 | 12 | 20 | 5 | 13 | 8 | 18 | 12.6 | 7 |
| Accounts Receivable | --- | 1 | 1 | 1 | 2 | 1 | 2 | 2.5 | 2.2 | 2.6 |
| Inventories | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Goodwill & Int. Ass. | --- | 26 | 13 | 13 | 13 | 16 | 17 | 16 | 16.1 | 15 |
| Total Liabilities | --- | 280 | 216 | 224 | 224 | 235 | 241 | 251 | 264 | 279 |
| Accounts Payable | --- | 2 | 1 | 2 | 0 | 1 | 1 | 0.5 | 2.1 | 2.2 |
| Long-Term Debt | --- | 130 | 104 | 114 | 114 | 114 | 114 | 114 | 113 | 109 |
| Shareholder's Equity | --- | 28 | 20 | 15 | 15 | 28 | 25 | 32 | 30 | 44 |
| LTD/E Ratio | --- | 4.69 | 5.19 | 7.62 | 7.70 | 4.11 | 4.64 | 3.56 | 3.75 | 2.45 |

Profitability & Per Share Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|------------------|------|------|-------|--------|--------|-------|------|------|-------|-------|
| Return on Assets | --- | --- | 7.9% | -1.1% | 1.9% | 1.2% | 0.8% | --- | 1.3% | 1.8% |
| Return on Equity | --- | --- | 89.5% | -14.3% | 30.5% | 14.5% | 8.5% | --- | 11.6% | 14.8% |
| ROIC | --- | --- | 15.2% | -2.0% | 3.5% | 2.3% | 1.6% | --- | 2.5% | 3.7% |
| Shares Out. | --- | --- | --- | 19.1 | 19.6 | 20.5 | 21.5 | --- | 22.9 | 23.3 |
| Revenue/Share | --- | 1.68 | 1.65 | 1.56 | 1.59 | 1.73 | 1.65 | --- | 1.83 | 1.92 |
| FCF/Share | --- | 0.51 | 0.05 | (0.35) | (0.50) | 0.32 | 0.02 | --- | 0.09 | (0.5) |

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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