

CADIZ INC  
Form 10-Q  
November 08, 2018

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United States  
Securities and Exchange Commission

Washington, D. C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
for the quarterly period ended September 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 0-12114

Cadiz Inc.

(Exact name of registrant specified in its charter)

DELAWARE 77-0313235  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

550 South Hope Street, Suite 2850  
Los Angeles, California 90071  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (213) 271-1600

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 every Interactive Data File required to be submitted 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 Non-accelerated filer

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Smaller Reporting Company      Emerging growth company

If an emerging growth company, indicate by checkmark 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 Exchange Act Rule 12b-2). Yes  
No

As of November 2, 2018, the Registrant had 24,517,059 shares of common stock, par value \$0.01 per share, outstanding.

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Cadiz Inc.

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 Condensed Consolidated Statements of Operations and Comprehensive Loss (Unaudited)

(\$ in thousands, except per share data)	For the Three Months Ended September 30,	
	2018	2017
Total revenues	\$ 112	\$ 111
Costs and expenses:		
General and administrative	2,536	2,456
Depreciation	64	69
Total costs and expenses	2,600	2,525
Operating loss	(2,488 )	(2,414 )
Interest expense, net	(3,829 )	(3,586 )
Interest income	77	9
Loss before income taxes	(6,240 )	(5,991 )
Income tax expense	-	1
Net loss and comprehensive loss applicable to common stock	\$(6,240 )	\$(5,992 )
Basic and diluted net loss per common share	\$(0.26 )	\$(0.26 )
Basic and diluted weighted average shares outstanding	24,451	22,857

See accompanying notes to the unaudited condensed consolidated financial statements.

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Cadiz Inc.

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 Condensed Consolidated Statements of Operations and Comprehensive Loss (Unaudited)

(\$ in thousands, except per share data)	For the Nine Months Ended September 30,	
	2018	2017
Total revenues	\$329	\$327
Costs and expenses:		
General and administrative	7,364	8,747
Depreciation	194	212
Total costs and expenses	7,558	8,959
Operating loss	(7,229 )	(8,632 )
Interest expense, net	(11,167)	(14,662)
Interest income	157	9
Loss on extinguishment of debt and debt refinancing	-	(3,501 )
Loss before income taxes	(18,239)	(26,786)
Income tax expense	4	3
Net loss and comprehensive loss applicable to common stock	\$(18,243)	\$(26,789)
Basic and diluted net loss per common share	\$(0.77 )	\$(1.19 )
Basic and diluted weighted average shares outstanding	23,809	22,471

See accompanying notes to the unaudited condensed consolidated financial statements.

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Cadiz Inc.

## Condensed Consolidated Balance Sheets (Unaudited)

	September 30, 2018	December 31, 2017
(\$ in thousands, except per share data)		
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 17,667	\$ 13,030
Accounts receivable	106	36
Prepaid expenses and other current assets	535	411
Total current assets	18,308	13,477
Property, plant, equipment and water programs, net	46,302	45,269
Goodwill	3,813	3,813
Other assets	3,901	3,946
Total assets	\$ 72,324	\$ 66,505
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
Current liabilities:		
Accounts payable	\$ 1,086	\$ 411
Accrued liabilities	889	2,281
Current portion of long-term debt	58	1,408
Warrant derivative liabilities	1,119	2,387
Total current liabilities	3,152	6,487
Long-term debt, net	133,287	123,768
Long-term lease obligations, net	14,121	13,276
Deferred revenue	750	750
Other long-term liabilities	923	923
Total liabilities	152,233	145,204
Stockholders' deficit:		
Common stock - \$.01 par value; 70,000,000 shares authorized at September 30, 2018 and December 31, 2017; shares issued and outstanding – 24,453,358 at September 30, 2018 and 22,987,434 at December 31, 2017	245	230
Additional paid-in capital	381,824	364,806
Accumulated deficit	(461,978)	(443,735)
Total stockholders' deficit	(79,909 )	(78,699 )
Total liabilities and stockholders' deficit	\$ 72,324	\$ 66,505

See accompanying notes to the unaudited condensed consolidated financial statements.





Cadiz Inc.

## Condensed Consolidated Statements of Cash Flows (Unaudited)

For the Nine  
Months  
Ended September  
30,  
2018      2017

(\$ in thousands)

## Cash flows from operating activities:

Net loss

\$(18,243) (26,789)

Adjustments to reconcile net loss to  
net cash used in operating activities:

Depreciation

194 212

Amortization of debt discount and issuance costs

3,002 2,829

Interest expense added to loan principal

7,246 6,884

Interest expense added to lease liability

827 718

Loss on debt conversion

83 56

Loss on early extinguishment of debt

- 3,501

Compensation charge for stock and share option awards

350 2,027

Unrealized (gain) loss on warrant derivative liabilities

(1,268 ) 3,747

Changes in operating assets and liabilities:

Accounts receivable

(70 ) (17 )

Prepaid expenses and other current assets

(124 ) 2,866

Other assets

45 (214 )

Accounts payable

502 (53 )

Accrued liabilities

(1,188 ) (3,493 )

Net cash used in operating activities

(8,644 ) (7,726 )

## Cash flows from investing activities:

Additions to property, plant and equipment and water programs

(1,258 ) (671 )

Net cash used in investing activities

(1,258 ) (671 )

## Cash flows from financing activities:

Net proceeds from the issuance of stock

14,581 -

Net proceeds from the issuance of long-term debt

- 57,190

Principal payments on long-term debt

(42 ) (44,910)

Net cash provided by financing activities

14,539 12,280

Net increase in cash, cash equivalents and restricted cash

4,637 3,883

Cash, cash equivalents and restricted cash, beginning of period

13,163 12,305

Cash, cash equivalents and restricted cash, end of period

\$17,800 \$16,188

See accompanying notes to the unaudited condensed consolidated financial statements.

Cadiz Inc.

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 Condensed Consolidated Statements of Stockholders' Deficit (Unaudited)

(\$ in thousands, except share data)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Deficit
Balance as of December 31, 2016	21,768,864	\$ 218	\$ 355,336	\$ (409,871 )	\$ (54,317 )
Issuance of shares to lenders	29,706	-	433	-	433
Issuance of shares pursuant to bond conversion	326,163	3	2,253	-	2,256
Stock-based compensation expense	405,643	4	2,122	-	2,126
Net loss and comprehensive loss	-	-	-	(26,789 )	(26,789 )
Balance as of September 30, 2017	22,530,376	\$ 225	\$ 360,144	\$ (436,660 )	\$ (76,291 )
Balance as of December 31, 2017	22,987,434	\$ 230	\$ 364,806	\$ (443,735 )	\$ (78,699 )
Issuance of shares pursuant to ATM Offering	1,159,718	12	14,570	-	14,582
Issuance of shares pursuant to bond conversion	279,480	3	2,098	-	2,101
Stock-based compensation expense	-	-	350	-	350
Issuance of shares pursuant to stock awards	26,726	-	-	-	-
Net loss and comprehensive loss	-	-	-	(18,243 )	(18,243 )
Balance as of September 30, 2018	24,453,358	\$ 245	\$ 381,824	\$ (461,978 )	\$ (79,909 )

See accompanying notes to the unaudited condensed consolidated financial statements.

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Cadiz Inc.

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Notes to the Condensed Consolidated Financial Statements

NOTE 1 – BASIS OF PRESENTATION

The Condensed Consolidated Financial Statements have been prepared by Cadiz Inc., also referred to as "Cadiz" or "the Company", without audit and should be read in conjunction with the Consolidated Financial Statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2017.

The foregoing Condensed Consolidated Financial Statements include the accounts of the Company and contain all adjustments, consisting only of normal recurring adjustments, which management considers necessary for a fair statement of the Company's financial position, the results of its operations and its cash flows for the periods presented and have been prepared in accordance with generally accepted accounting principles.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates and such differences may be material to the financial statements. The results of operations for the three and nine months ended September 30, 2018 are not necessarily indicative of results for the entire fiscal year ending December 31, 2018.

Liquidity

The Condensed Consolidated Financial Statements of the Company have been prepared using accounting principles applicable to a going concern, which assumes realization of assets and settlement of liabilities in the normal course of business. The Company incurred losses of \$18.2 million for the nine months ended September 30, 2018, compared to \$26.8 million for the nine months ended September 30, 2017. The Company had working capital of \$15.2 million at September 30, 2018 and used cash in its operations of \$8.6 million for the nine months ended September 30, 2018.

Cash requirements during the nine months ended September 30, 2018 primarily reflect certain administrative costs related to the Company's water project development efforts. Currently, the Company's sole focus is the development of its land and water assets.

In March 2018, the Company entered into an At Market Issuance Sales Agreement with B. Riley FBR, Inc., under which the Company could issue and sell shares of its common stock having an aggregate offering price of up to \$15 million from time to time in an "at the market" offering (the "ATM Offering") through B. Riley FBR acting as its sales agent. The Company completed the offering during May 2018, having issued 1,159,718 shares of common stock in the ATM Offering for gross proceeds of \$15 million and aggregate net proceeds of approximately \$14.6 million.

In May 2017, the Company entered into a \$60 million credit agreement with funds affiliated with Apollo Global Management, LLC ("Apollo") that replaced and refinanced its then existing \$45 million senior secured mortgage debt and provided \$15 million of new senior debt to fund immediate construction related expenditures ("Senior Secured Debt").

The Company's Senior Secured Debt and its convertible notes contain representations, warranties and covenants that are typical for agreements of this type, including restrictions that would limit the Company's ability to incur additional indebtedness, incur liens, pay dividends or make restricted payments, dispose of assets, make investments and merge or consolidate with another person. However, while there are affirmative covenants, there are no financial maintenance covenants and no restrictions on the Company's ability to issue additional common stock to fund future working capital needs. The debt covenants associated with the Senior Secured Debt were negotiated by the parties with a view towards the Company's operating and financial condition as it existed at the time the agreements were executed. At September 30, 2018, the Company was in compliance with its debt covenants.

The Company's cash resources provide the Company with sufficient funds to meet its working capital needs for a period beyond one year from this quarterly report issuance date. Additionally, the Company has principal and interest payments aggregating approximately \$80.3 million coming due in March 2020 related to its Convertible Senior Notes to the extent the noteholders, who have the right to convert at any time into the Company's common stock at a conversion rate of \$6.75 per share, do not convert prior to March 2020. The Company's Senior Secured Debt of approximately \$65.1 million as of September 30, 2018, could also become due as early as December 2019, if the Convertible Senior Notes have not been converted by that time and the Company's stock price is less than 120% of the conversion rate and according to additional terms of the debt agreement as further disclosed in the Company's 2017 Form 10-K. The Company may meet working capital requirements beyond this one year period as well as the payment due under the terms of the Convertible Senior Notes through a variety of means, including construction financing, equity placements, through the sale or other disposition of assets, extension or refinancing of the Senior Secured Debt or the Convertible Senior Notes due March 2020, or reductions in operating costs. Equity placements would be undertaken only to the extent necessary, so as to minimize the dilutive effect of any such placements upon the Company's existing stockholders. Further, the Company's option to acquire an additional 124-mile extension of its Northern Pipeline will require a \$20 million payment by December 2018. The Company does not currently have the cash resources on hand to exercise this option and has engaged an investment banker to pursue alternatives intended to provide the resources to allow the Company to exercise this option. If the Company is unable to exercise this option, then its Northern Pipeline opportunities will be limited to the 96-mile segment it currently owns.

Limitations on the Company's liquidity and ability to raise capital may adversely affect it. Sufficient liquidity is critical to meet the Company's resource development activities. Although the Company currently expects its sources of capital to be sufficient to meet its near-term liquidity needs, there can be no assurance that its liquidity requirements will continue to be satisfied. Specifically, the Company does not have adequate resources currently to meet the obligations related to the (1) Senior Secured Debt which could come due as early as December 2019 as described above or (2) the Convertible Senior Notes coming due in March 2020 to the extent these notes are not converted. Accordingly, the Company will need to refinance or extend the maturity date of these debt obligations or raise additional capital from other sources. If the Company cannot raise needed funds, it might be forced to make substantial reductions in its operating expenses, which could adversely affect its ability to implement its current business plan and ultimately its viability as a company.

## Supplemental Cash Flow Information

Under the terms of the Senior Secured Debt, the Company is required to pay 25% of all future quarterly interest payments in cash. During the nine months ended September 30, 2018, approximately \$958 thousand in interest payments on the corporate secured debt was paid in cash. No other payments are due on the Senior Secured Debt or the Company's convertible notes prior to their maturities.

During the nine months ended September 30, 2018, approximately \$2.11 million in convertible notes were converted by certain of the Company's lenders. As a result, 279,480 shares of common stock were issued to the lenders.

## Recent Accounting Pronouncements

### Accounting Guidance Not Yet Adopted

In August 2018, the Financial Accounting Standards Board ("FASB") issued an accounting standards update which modifies the disclosure requirements for fair value measurements. This update is effective for fiscal years beginning after December 15, 2019, and for interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating this new guidance and cannot determine the impact of this standard at this time.

In June 2018, the FASB issued an accounting standards update which simplifies the accounting for share-based payments granted to nonemployees for goods and services. This update is effective for fiscal years beginning after December 15, 2018, and for interim periods within those fiscal years. The Company is currently evaluating this new guidance and cannot determine the impact of this standard at this time.

In February 2016, the FASB issued an accounting standards update related to lease accounting, which establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition. Similarly, lessors will be required to classify leases as sales-type, finance or operating, with classification affecting the pattern of income recognition. Classification for both lessees and lessors will be based on an assessment of whether risks and rewards as well as substantive control have been transferred through a lease contract. This guidance is effective January 1, 2019, but early adoption is permitted. The Company is currently evaluating this new guidance and cannot determine the impact of this standard at this time.

In July 2017, the FASB issued an accounting standards update to provide new guidance for the classification analysis of certain equity-linked financial instruments, or embedded features, with down round features, as well as clarify existing disclosure requirements for equity-classified instruments. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. The guidance is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020, with early adoption permitted. The Company is currently evaluating this new guidance and cannot determine the impact of this standard at this time.

## Accounting Guidance Adopted

In May 2014, the FASB issued an accounting standards update on revenue recognition including enhanced disclosures. Under the new standard, revenue is recognized when (or as) a good or service is transferred to the customer and the customer obtains control of the good or service. The Company adopted this guidance on January 1, 2018, and the new standard did not have a material impact on the Company's condensed consolidated financial statements.

In August 2016, the FASB issued an accounting standards update which eliminates the diversity in practice related to the classification of certain cash receipts and payments in the statement of cash flows, by adding or clarifying guidance on eight specific cash flow issues. This guidance is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company adopted this guidance on January 1, 2018, and the new standard had no impact on the Company's condensed consolidated financial statements.

In November 2016, the FASB issued an accounting standards update which 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 Company adopted this guidance in the first quarter of 2018. The balance of cash, cash equivalents, and restricted cash as shown in the condensed consolidated statements of cash flows is comprised of the following:

<u>Cash, Cash Equivalents and Restricted Cash</u> (in thousands)	September 30, 2018	December 31, 2017	September 30, 2017
Cash and Cash Equivalents	\$ 17,667	\$ 13,030	\$ 16,055
Restricted Cash included in Other Assets	133	133	133
Cash, Cash Equivalents and Restricted Cash in the Consolidated Statement of Cash Flows	\$ 17,800	\$ 13,163	\$ 16,188

The restricted cash amounts included in Other Assets primarily represent a deposit from a water project participant related to a cost-sharing agreement.

In May 2017, the FASB issued an accounting standards update which clarifies which changes to terms or conditions of a share-based payment award require an entity to apply modification accounting, in accordance with Topic 218. This guidance is effective for annual periods beginning after December 15, 2017, and interim periods within those. The Company adopted this guidance on January 1, 2018, and the new standard had no impact on the Company's condensed consolidated financial statements.

**NOTE 2 – LONG-TERM DEBT**

The carrying value of the Company's secured debt approximates fair value. The fair value of the Company's debt (Level 2) is determined based on an estimation of discounted future cash flows of the debt at rates currently quoted or offered to the Company by its lenders for similar debt instruments of comparable maturities by its lenders.

The fair value of the Company's convertible debt exceeds its carrying value of approximately \$72.6 million, which includes accreted interest, by approximately \$24.6 million due to the increased value of its conversion feature. The conversion feature's fair value increases as the Company's common stock price increases. The fair value of the conversion feature (Level 3) is determined using the Black-Scholes model. Significant inputs to the model were the conversion price (\$6.75), the number of shares of common stock that could be acquired upon conversion as of September 30, 2018, the Company's stock price as of September 30, 2018 of \$11.15 and stock volatility of 44%, which was determined using our publicly-traded stock price over the last 18 months.

**NOTE 3 – STOCK-BASED COMPENSATION PLANS AND WARRANTS**

The Company has issued options and has granted stock awards pursuant to its 2009 Equity Incentive Plan and 2014 Equity Incentive Plan, as described below.

**2009 Equity Incentive Plan**

The 2009 Equity Incentive Plan was approved by stockholders at the 2009 Annual Meeting. The plan provides for the grant and issuance of up to 850,000 shares and options to the Company's employees and consultants. The plan became effective when the Company filed a registration statement on Form S-8 on December 18, 2009. All options issued under the 2009 Equity Incentive Plan have a ten-year term with vesting periods ranging from issuance date to 24 months.

**2014 Equity Incentive Plan**

The 2014 Equity Incentive Plan was approved by stockholders at the June 10, 2014 Annual Meeting. The plan provides for the grant and issuance of up to 675,000 shares and options to the Company's employees, directors and consultants. Upon approval of the 2014 Equity Incentive Plan, all shares of common stock that remained available for award under the 2009 Equity Incentive Plan were cancelled.

Under the 2014 Equity Incentive Plan, each outside director receives \$30,000 of cash compensation and receives a deferred stock award consisting of shares of the Company's common stock with a value equal to \$20,000 on June 30 of each year. The award accrues on a quarterly basis, with \$7,500 of cash compensation and \$5,000 of stock earned for each fiscal quarter in which a director serves. The deferred stock award vests automatically on January 31 in the year following the award date.

All options that have been issued under the above plans have been issued to officers, employees and consultants of the Company. In total, options to purchase 507,500 shares were unexercised and outstanding on September 30, 2018 under the two equity incentive plans.

The Company recognized no stock option related compensation costs in each of the nine months ended September 30, 2018 and 2017. Additionally, no options were exercised during the nine months ended September 30, 2018.

#### Stock Awards to Directors, Officers, and Consultants

The Company has granted stock awards pursuant to its 2009 Equity Incentive Plan and 2014 Equity Incentive Plan.

Of the total 850,000 shares reserved under the 2009 Equity Incentive Plan, 297,265 shares were issued as share grants and 507,500 were issued as options. Upon approval of the 2014 Equity Incentive Plan in June 2014, 45,235 shares remaining available for award under the 2009 Equity Incentive Plan were cancelled.

Of the total 675,000 shares reserved under the 2014 Equity Incentive Plan, 634,204 shares have been awarded to the Company directors, consultants and employees as of September 30, 2018. Of the 634,204 shares awarded, 10,224 shares were awarded to the Company's directors for services performed during the plan year ended June 30, 2018. These shares will vest and be issued on January 31, 2019.

The Company recognized stock-based compensation costs of \$123,000 and \$107,000 for the three months ended September 30, 2018 and 2017, respectively; \$350,000 and \$2,027,000 for the nine months ended September 30, 2018 and 2017, respectively.

#### Warrants

In conjunction with the closing of the Senior Secured Debt in May 2017, the Company issued to its lender a warrant to purchase an aggregate 362,500 shares of its common stock ("Warrant"). The Company recorded a debt discount at the time of the closing of the Senior Secured Debt in the amount of \$2.9 million which was the fair value of the Warrant at the time it was issued. The debt discount is being amortized through December 2019. The fair value of the Warrant is remeasured each reporting period, and the change in warrant value is recorded as an adjustment to the derivative liability. The warrant has a five-year term and an exercise price of \$14.94 per share, subject to adjustment.

Total unrealized gains of \$1.27 million for warrant liabilities accounted for as derivatives have been recorded in interest expense in the nine months ended September 30, 2018.

#### NOTE 4 – INCOME TAXES

Effective January 1, 2018, the Tax Cuts and Jobs Act ("TCJA"), which was enacted in the United States on December 22, 2017, led to the reduction of the effective federal corporate tax rate from 35% to 21%. As of September 30, 2018, the Company had net operating loss ("NOL") carryforwards of approximately \$302 million for federal income tax purposes and \$182 million for California state income tax purposes. Such carryforwards expire in varying amounts through the year 2038. Use of the carryforward amounts is subject to an annual limitation as a result of ownership changes.



As of September 30, 2018, the Company possessed unrecognized tax benefits totaling approximately \$1.8 million. None of these, if recognized, would affect the Company's effective tax rate because the Company has recorded a full valuation allowance against these assets.

The Company's tax years 2015 through 2017 remain subject to examination by the Internal Revenue Service, and tax years 2014 through 2017 remain subject to examination by California tax jurisdictions. In addition, the Company's loss carryforward amounts are generally subject to examination and adjustment for a period of three years for federal tax purposes and four years for California purposes, beginning when such carryovers are utilized to reduce taxes in a future tax year.

Because it is more likely than not that the Company will not realize its net deferred tax assets, it has recorded a full valuation allowance against these assets. Accordingly, no deferred tax asset has been reflected in the accompanying condensed consolidated balance sheet.

#### NOTE 5 – NET LOSS PER COMMON SHARE

Basic net loss per share is computed by dividing the net loss by the weighted-average common shares outstanding. Options, deferred stock units, warrants and the zero coupon term loan convertible into or exercisable for certain shares of the Company's common stock were not considered in the computation of net loss per share because their inclusion would have been antidilutive. Had these instruments been included, the fully diluted weighted average shares outstanding would have increased by approximately 11,446,000 and 11,193,000 for the three months ended September 30, 2018 and 2017, respectively; and 11,324,000 and 10,888,000 for the nine months ended September 30, 2018 and 2017, respectively.

#### NOTE 6 – FAIR VALUE MEASUREMENTS

The following table presents information about warrant derivative liabilities that are measured at fair value on a recurring basis as of September 30, 2018, and indicate the fair value hierarchy of the valuation techniques we utilized to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities. We consider a security that trades at least weekly to have an active market. Fair values determined by Level 2 inputs utilize data points that are observable, such as quoted prices, interest rates and yield curves. Fair values determined by Level 3 inputs are unobservable data points for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

(in thousands)	Derivatives at Fair Value as of September 30, 2018			
	Level			
	1	2	Level 3	Total
Warrant derivative liabilities	-	-	(1,119)	(1,119)
Total warrant derivative liabilities	\$ -	\$ -	\$ (1,119)	\$ (1,119)

The following table presents a reconciliation of Level 3 activity for the three month period ended September 30, 2018:

(in thousands)	Level 3 Liabilities Warrant Derivative Liabilities
Balance at June 30, 2018	\$ 1,528
Unrealized Gains, net	(409 )
Balance at September 30, 2018	\$ 1,119

The following table presents a reconciliation of Level 3 activity for the nine month period ended September 30, 2018:

(in thousands)	Level 3 Liabilities Warrant Derivative Liabilities
Balance at December 31, 2017	\$ 2,387
Unrealized Gains, net	(1,268 )
Balance at September 30, 2018	\$ 1,119

The Warrants are Level 3 and are valued using a lattice model that uses unobservable inputs such as volatility and future probability of issuing new shares.

## ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, the following discussion contains trend analysis and other forward-looking statements. Forward-looking statements can be identified by the use of words such as "intends", "anticipates", "believes", "estimates", "projects", "forecasts", "expects", "plans" and "proposes". Although we believe that the expectations reflected in these forward-looking statements are based on reasonable assumptions, there are a number of risks and uncertainties that could cause actual results to differ materially from these forward-looking statements. These include, among others, our ability to maximize value from our land and water resources; and our ability to obtain new financings as needed to meet our ongoing working capital needs. See additional discussion under the heading "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017.

### Overview

We are a land and water resource development company with over 45,000 acres of land in three areas of eastern San Bernardino County, California. Virtually all of this land is underlain by high-quality, naturally recharging groundwater resources, and is situated in proximity to the Colorado River and the Colorado River Aqueduct ("CRA"), California's primary mode of water transportation for imports from the Colorado River into the State. Our properties are suitable for various uses, including large-scale agricultural development, groundwater storage and water supply projects. Our main objective is to realize the highest and best use of these land and water resources in an environmentally responsible way.

We believe that the long-term highest and best use of our land and water assets will be realized through the development of a combination of water supply and storage projects at our properties. Therefore, we have primarily focused on the development of the Cadiz Valley Water Conservation, Recovery and Storage Project ("Water Project" or "Project"), which will capture and conserve millions of acre-feet<sup>1</sup> of native groundwater currently being lost to evaporation from the aquifer system beneath our 35,000-acre property in the Cadiz and Fenner valleys of eastern San Bernardino County (the "Cadiz/Fenner Property"), and deliver it to water providers throughout Southern California (see "Water Resource Development"). A second phase of the Water Project would offer storage of up to one million acre-feet of imported water in the aquifer system. We believe that the ultimate implementation of this Water Project will provide a significant source of future cash flow.

The primary factor driving the value of such projects is ongoing pressure on California's traditional water supplies and the resulting demand for new, reliable supply solutions that can meet both immediate and long-term water needs. Available water supply in Southern California is constrained by regulatory restrictions on each of the State's three main water sources: the CRA, the State Water Project, which provides water supplies from Northern California to the central and southern parts of the state, and the Los Angeles Aqueduct, which delivers water from the eastern Sierra Nevada mountains to Los Angeles. Southern California's water providers rely on imports from these systems for a majority of their water supplies, but deliveries from all three into the region are often below capacity, even in wet years.

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<sup>1</sup> One acre-foot is equal to approximately 326,000 gallons or the volume of water that will cover an area of one acre to a depth of one-foot. An acre-foot is generally considered to be enough water to meet the annual water needs of two average California households.

Further, the availability of supplies in California differs greatly from year to year due to natural hydrological variability. Over the last decade, California struggled through a historic drought featuring record-low winter precipitation. Then, following a series of strong storms that delivered record amounts of rain and snow during the 2016-2017 winter, the State recovered. Yet, the following winter delivered few precipitation events and, through October 2018, 85% of the State is again abnormally dry with all of Southern California experiencing drought conditions, according to the US Drought Monitor. Drought, dry conditions and rapid swings between wet and dry years challenges California's traditional supply system and supports the need for reliable storage and local supply.

Given the variety of challenges and limitations faced by the State's traditional infrastructure, Southern California water providers are presently pursuing investments in storage, supply and infrastructure to meet long-term demand. The Cadiz Water Project is a local supply option in Southern California that would help address the region's water supply challenges by providing new reliable supply and local groundwater storage opportunities (see "Water Resource Development" below) in both dry and wet years. Following a multi-year California Environmental Quality Act ("CEQA") review and permitting process, the Water Project received permits that allow the capture and conservation of 2.5 million acre-feet of groundwater over 50 years in accordance with the terms of a groundwater management plan approved by San Bernardino County, the public agency responsible for groundwater use at the project area.

In addition to our Water Project proposal, we are engaged in agricultural joint ventures at the Cadiz/Fenner Property that put some of the groundwater currently being lost to evaporation from the underlying aquifer system to immediate beneficial use. We have farmed portions of the Cadiz/Fenner Property since the late 1980s relying on groundwater from the aquifer system for irrigation and the site is well-suited for various permanent and seasonal crops. Presently, the property has 2,100 acres leased for cultivation of a variety of crops, including citrus, dried-on-the-vine raisins and seasonal vegetables.

Our current working capital requirements relate largely to the final development activities associated with the Water Project and those activities consistent with the Water Project related to further development of our land and agricultural assets. While we continue to believe that the ultimate implementation of the Water Project will provide the primary source of our future cash flow, we also believe there is significant additional value in our underlying agricultural assets.

We also continue to explore additional uses of our land and water resource assets, including renewable energy development, the marketing of our approved desert tortoise land conservation bank, which is located on our properties outside the Water Project area, and other long-term legacy uses of our properties, such as habitat conservation and cultural development.

## Water Resource Development

The Water Project is designed to capture and conserve millions of gallons of renewable native groundwater currently being lost to evaporation from the aquifer system underlying our Cadiz/Fenner Property and provide a new reliable water supply for approximately 400,000 people in Southern California. In this first phase, Phase I, the total quantity of groundwater to be recovered and conveyed to Water Project participants will not exceed a long-term annual average of 50,000 acre-feet per year for 50 years. The Water Project also offers participants in Phase I the ability to carry-over their annual supply and store it in the groundwater basin from year to year. Up to 150,000 acre-feet can be stored as part of Phase I. A second phase of the Water Project, Phase II, will offer an additional 850,000 acre-feet of capacity that can store imported water supplies at the project area for future dry years.

Water Project facilities required for Phase I primarily include, among other things:

- High-yield wells designed to efficiently recover available native groundwater at the Water Project area;
- A water conveyance pipeline to deliver water from the well-field to the CRA for further delivery to Project participants; and
- An energy source to provide power to the well-field, pipeline and pumping facilities.
- Water treatment facility at the wellfield to meet anticipated water quality requirements set by operator of the CRA.

If an imported water storage component of the Project is ultimately implemented in Phase II, the following additional facilities would be required, among other things:

- Facilities to pump water through the conveyance pipeline from the CRA to the Water Project well-field and/or through the Company's pipeline from Cadiz to Barstow, CA; and
- Spreading basins, which are shallow settling ponds that will be configured to efficiently percolate water from the ground surface down to the water table using subsurface storage capacity for the storage of water.

### Phase I

Phase I has been fully reviewed and permitted in accordance with the California Environmental Quality Act (CEQA). In May 2016, all permits and approvals were sustained in the California Court of Appeal and are no longer subject to further litigation. As a result, the Project presently is permitted to provide an average of 50,000 acre-feet of water for 50 years to meet municipal and industrial (M&I) water needs in Southern California.

In October 2017, the US Bureau of Land Management ("BLM") provided a letter finding that the Project's proposed use of a portion of the Arizona & California Railroad Company ("ARZC") right-of-way from Cadiz to the CRA in Freda, California to construct and operate the Water Project's water conveyance pipeline and related railroad improvements is within the scope of the original right-of-way grant and not subject to additional permitting. The buried pipeline would be constructed parallel to the railroad tracks and be used to convey water between our Cadiz Valley property and the CRA.

Construction of Water Project facilities that would allow for the delivery of up to 75,000 acre-feet in any one year is expected to cost approximately \$310 million and will require capital financing that we expect will be secured by definitive Purchase and Sale Agreements with Project participants and the new facility assets.

In addition to finalizing construction financing terms, prior to construction, the Water Project must (1) finalize contracts with Project participating agencies, (2) secure transportation arrangements to deliver water into each participant's service area, and (3) complete final design, engineering and construction permitting. Below is a discussion of present activities to advance these objectives.

(1) Contracts with Public Water Agencies or Private Water Utilities

The Company has executed Letters of Intent ("LOIs"), option agreements and purchase agreements, or contracts (collectively, "Agreements") with public water agencies and private water utilities in California during the Project's development. These participating agencies serve more than one million customers in cities throughout California's San Bernardino, Riverside, Los Angeles, Orange, Imperial and Ventura Counties. Twenty percent of Water Project supplies have been reserved for San Bernardino County-based agencies.

Santa Margarita Water District ("SMWD"), Orange County's second largest water provider, was the first participant to convert its option agreement and adopt resolutions approving a Water Purchase and Sale Agreement for 5,000 acre-feet of water. The structure of the SMWD purchase agreement calls for an annually adjusted water supply payment, plus a pro rata portion of the capital recovery charge and operating and maintenance costs. The capital recovery charge is calculated by amortizing the total capital investment by the Company over a 30-year term.

Agreements entered into prior to the beginning of the CEQA review process provide to participants the right to acquire an annual supply of 5,000 acre-feet of water at \$775 per acre-foot (2010 dollars, subject to adjustment), which is competitive with the incremental cost of new water. In addition, these agencies received options to acquire storage rights in the Water Project to allow for the management of their Water Project supplies in complement with their own water resources. Up to 150,000 acre-feet of carry-over storage is available for reservation by the agencies prior to construction commencement. Participants that elect to achieve year-to-year flexibility in their use of Project water by utilizing carry-over storage will reserve storage capacity for \$1,500 per acre-foot prior to construction.

LOIs that have been entered into since completion of the CEQA review process reserve supplies from the Water Project at \$960 per acre-foot (2014 dollars, subject to adjustment). These LOIs also include the option to reserve carry-over storage capacity for \$1,500 per acre-foot prior to construction.

Presently, total reservations of supplies from the Water Project via these Agreements are in excess of Water Project capacity. Prior to construction of the Water Project, we expect to convert existing option agreements and LOIs to purchase agreements. We are working collaboratively with the participating water agencies to account for any oversubscription in the final definitive Purchase and Sale Agreements and allow for inclusive participation across Southern California.

(2) Conveyance Arrangements

Prior to construction of the Water Project, and in coordination with final participation contracts described in (1) above, an agreement and terms for moving water supplies in the CRA must be negotiated with Metropolitan Water District of Southern California ("Metropolitan"), which owns and controls the CRA.

Water supplies conserved by the Project would enter the CRA at the termination of the project's conveyance pipeline near Rice, CA. The CEQA process considered a variety of options to enter the CRA and assumed final entry into the CRA would be determined by MWD in consultation with the Project's participating agencies. Once arrangements are reached, the Metropolitan Board would take action as a responsible agency under CEQA regarding the terms and conditions of the Water Project's use of the CRA to transport water to its participating agencies.

There is no application yet before Metropolitan related to entry and transportation of Project supplies, but we expect such a formal application will be filed by SMWD, the Project's lead agency, as the Project's contractual arrangements with participants are finalized. Any agreement as to the terms and conditions of the Water Project's use of the CRA will be negotiated between and entered into by Metropolitan and the Project participating agencies, not the Company. Discussions with Metropolitan regarding conveyance of Project water in the CRA have been led by SMWD, the Water Project's CEQA lead agency, and are ongoing.

Water Project supplies entering the CRA will comply with Metropolitan's published engineering, design and water quality standards and will be subject to all applicable fees and charges routinely established by Metropolitan for the conveyance of water within its service territory. Total dissolved solids or salts in the Cadiz water supply are substantially lower than the water in the CRA. Other constituents that are already lower than State and Federal standards but potentially higher than the water in the CRA will be lowered via treatment to ambient levels or removed entirely. We believe there are multiple benefits that can be secured by MWD upon making space reasonably available for Water Project supplies and providing the region the flexibility of relying on the Water Project in both wet and dry years.

Northern Pipeline

We currently own a 96-mile existing idle natural gas 30-inch pipeline that extends from the Cadiz/Fenner Property to Barstow, California and we intend to convert this pipeline to allow for the transportation of water. The Barstow area serves as a hub for water delivered from northern and central California to communities in Southern California's High Desert.

Initial feasibility studies have indicated that, upon conversion, the 30-inch pipeline could transport between 18,000 and 30,000 acre-feet of water per year between the Water Project area and the Central and Northern California water transportation network. As a result, this pipeline could diversify delivery opportunities for the Water Project and the Company's broader water resource development efforts.

If this pipeline were to become operational, then the Water Project would link the Colorado River Aqueduct and State Water Project systems – two of Southern California's main water delivery systems - providing flexible opportunities for both supply and storage. The Northern Pipeline could deliver Phase I supplies, either directly or via exchange, to existing and potential customers of Phase I of the Project. Any use of the pipeline would be conducted in conformity with the Water Project's groundwater management plan and is subject to further CEQA evaluation and potentially federal environmental permitting.

In addition, we hold an option to purchase a further 124-mile segment of this pipeline from Barstow to Wheeler Ridge, California, for \$20 million. This option expires in December 2018. We do not currently have the cash resources on hand to exercise this option and have engaged an investment banker to pursue alternatives intended to provide the resources that would allow us to exercise it. If we are unable to exercise this option, then our Northern Pipeline opportunities will be limited to the 96-mile segment we currently own.

### (3) Final Design and Permitting

As a component of completing contract terms with participating agencies and related wheeling arrangements with Metropolitan, we must also finalize design of Project facilities and acquire relevant construction permits with state and local agencies. Together with SMWD we have engaged engineering and environmental consultants to complete design plans for the 43-mile pipeline, Project wellfield, any necessary water treatment facilities, and facilities required to connect to the Metropolitan system at and near the CRA. This work is ongoing and expected to proceed in coordination with the negotiation of contracts and wheeling arrangements.

Once facility design and layout near completion, we will need to obtain additional permits and approvals from state or local entities prior to construction. This may include but is not limited to confirmation of existing access rights, easements and rights-of-way, for areas that may be crossed by Project facilities in the Project area subject to final pipeline configuration.

### Phase II

In a second phase of the Water Project, we expect to make available up to one million acre-feet of capacity in the aquifer system for storage of surplus water conveyed to the Project area. Under the Imported Water Storage Component, or Phase II, water from the Colorado River or the State Water Project, via some or all of an existing 220-mile pipeline that extends from Wheeler Ridge, California southeast to Barstow and there onwards to our Cadiz/Fenner property (see "Northern Pipeline", above), could be conveyed to spreading basins that would be constructed on our private property to percolate into the aquifer system and held in storage. When needed, previously stored water would be returned to Phase II participating agencies via the Project's 43-mile conveyance pipeline to the CRA, described above, or the Northern Pipeline.



Phase II has already been the subject of programmatic environmental review in accordance with CEQA, but still requires project-level environmental review and permitting once participating agencies are identified. Phase II may also require federal permits subject to the National Environmental Policy Act, or NEPA.

#### Agricultural Development

Our Cadiz/Fenner Property, consisting of approximately 35,000 acres of desert land, is zoned for agricultural development. In 1993, we secured conditional use permits to develop agriculture on up to 9,600 acres of the property and withdraw groundwater from the underlying aquifer system for irrigation. We have since maintained various levels of crops on the Property as we developed the Water Project. In 2013, we entered into a lease agreement with a third party to develop up to 1,480 acres of lemons at the site, 640 acres of which have been planted to date.

In February 2016, we entered into a lease agreement with Fenner Valley Farms LLC ("FVF"), a subsidiary of Water Asset Management LLC, a related party, pursuant to which FVF leased, for a 99-year term, 2,100 acres at the Cadiz/Fenner property to be used to plant, grow and harvest agricultural crops ("FVF Lease"). As consideration for the lease, FVF paid the Company a one-time payment of \$12,000,000 in February 2016. The acreage that was historically farmed by the Company and the acreage that is leased to a third party to develop lemons was included within the leased acreage. Following entry into this lease, we are no longer directly involved in the current agricultural operations at the site and all agricultural revenue is derived pursuant to the FVF Lease.

As part of the agricultural development to be conducted under the lease arrangements, the groundwater production capacity of the property's existing well-field is expected to be enhanced through infrastructure improvements that are complementary to the Water Project. While any additional well-field development for agricultural use would be financed by our agricultural partners as provided under our agricultural lease arrangements, we retained a call feature that allows us, at any time in the initial 20 years, to acquire the well-field and integrate any new agricultural well-field infrastructure developed into the Water Project's facilities.

#### Additional Eastern Mojave Properties

We also own approximately 11,000 acres outside of the Cadiz/Fenner Valley area in two locations within the Mojave Desert in eastern San Bernardino County.

Our primary landholding outside of the Cadiz area is approximately 9,000 acres in the Piute Valley. This landholding is located approximately 15 miles from the resort community of Laughlin, Nevada, and about 12 miles from the Colorado River town of Needles, California. Extensive hydrological studies, including the drilling and testing of a full-scale production well, have demonstrated that this landholding is underlain by high-quality groundwater. The aquifer system underlying this property is naturally recharged by precipitation (both rain and snow) within a watershed of approximately 975 square miles and could be suitable for a water supply project, agricultural development or solar energy production. These properties are located in or adjacent to areas designated by the federal government as National Monument, Critical Desert Tortoise Habitat and/or Desert Wilderness Areas and are suitable candidates for preservation and conservation (see "Land Conservation Bank" below).

Additionally, we own acreage located near Danby Dry Lake in Ward Valley, approximately 30 miles southeast of our Cadiz/Fenner Valley properties. The Danby Dry Lake property is located approximately 10 miles north of the CRA. Initial hydrological studies indicate that the area has excellent potential for a water supply project. Certain of the properties in this area may also be suitable for agricultural development and/or preservation and conservation.

#### Land Conservation Bank

Approximately 7,500 acres of our properties outside of the Cadiz/Fenner Valley area in the Piute Valley are located within terrain designated by the federal government as Critical Desert Tortoise Habitat and/or Desert Wilderness Areas and have limited development opportunities. In February 2015, the California Department of Fish and Wildlife approved our establishment of the Fenner Valley Desert Tortoise Conservation Bank ("Fenner Bank"), a land conservation bank that makes available these properties for mitigation of impacts to tortoise and other sensitive species that would be caused by development across the Southern California desert. Under its enabling documents, the Fenner Bank offers credits that can be acquired by entities that must mitigate or offset impacts linked to planned development. For example, this bank can service the mitigation requirements of renewable energy, military, residential and commercial development projects being considered throughout the desert. Credits sold by the Fenner Bank will fund our permanent preservation of the land as well as research by outside entities, including San Diego Zoo Global, into desert tortoise health and species protection.

#### Northern Pipeline

The Northern Pipeline, described above, also represents new opportunities for the Company independent of the Water Project to offer water transportation to locations along the 220-mile pipeline route that are not presently interconnected by existing water infrastructure. The pipeline crosses California's major water infrastructure as well as urban and agricultural centers and can be utilized to transport water, independent of the Water Project, between users who presently lack direct interconnections along the pipeline route. We are presently engaged in discussions with parties that may be interested in such transportation. The ability to serve points along the 124-mile portion of the pipeline from Barstow to Wheeler Ridge is dependent upon our exercise of the option agreement, described above, that expires in December 2018. If we are unable to exercise this option, then our Northern Pipeline opportunities will be limited to the 96-mile segment we currently own.

#### Other Opportunities

Other opportunities in the water and agricultural or related infrastructure business complementary to our current objectives could provide new opportunities for our Company.

Over the longer-term, we believe the population of Southern California, Nevada and Arizona will continue to grow, and that, in time, the economics of commercial and residential development at our properties may become attractive.

We remain committed to the sustainable use of our land and water assets and will continue to explore all opportunities for environmentally responsible development of these assets. We cannot estimate which of these opportunities will ultimately be utilized.

## Results of Operations

Three Months Ended September 30, 2018, Compared to Three Months Ended September 30, 2017

We have not received significant revenues from our water resource and real estate development activity to date. Our revenues have been limited to rental income from the FVF Lease (see "Agricultural Development", above). As a result, we have historically incurred a net loss from operations. We had revenues of \$112 thousand for the three months ended September 30, 2018, compared to \$111 thousand for the three months ended September 30, 2017. We incurred a net loss of \$6.2 million in the three months ended September 30, 2018, compared to a \$6.0 million net loss during the three months ended September 30, 2017.

Our primary expenses are our ongoing overhead costs associated with the development of the Water Project (i.e., general and administrative expense) and our interest expense. We will continue to incur non-cash expenses in connection with our management and director equity incentive compensation plans.

Revenues Revenue totaled \$112 thousand for the three months ended September 30, 2018, compared to \$111 thousand for the three months ended September 30, 2017. Revenues are primarily related to rental income from the FVF Lease (see "Agricultural Development", above).

General and Administrative Expenses General and Administrative Expenses, exclusive of stock-based compensation costs, totaled \$2.4 million for each of the three months ended September 30, 2018 and 2017.

Compensation costs for stock and option awards for the three months ended September 30, 2018, were \$123 thousand, compared to \$106 thousand for the three months ended September 30, 2017.

Depreciation Depreciation expense totaled \$64 thousand during the three months ended September 30, 2018, compared to \$69 thousand during the three months ended September 30, 2017.

Interest Expense, net Net interest expense totaled \$3.8 million during the three months ended September 30, 2018 compared to \$3.6 million during the same period in 2017. The following table summarizes the components of net interest expense for the two periods (in thousands):

	Three Months Ended September 30,	
	2018	2017
Interest on outstanding debt	\$3,195	\$3,013
Unrealized gain on warrants, net	(409 )	(421 )
Amortization of debt discount	1,021	947
Amortization of deferred loan costs	22	47
	\$3,829	\$3,586

Interest Income Interest income totaled \$77 thousand for the three months ended September 30, 2018, compared to \$9 thousand for the three months ended September 30, 2017.

Income Taxes Income tax expense was zero for the three months ended September 30, 2018, compared to \$1 thousand for the three months ended September 30, 2017. See Note 4 to the Condensed Consolidated Financial Statements – "Income Taxes".

Nine Months Ended September 30, 2018, Compared to Nine Months Ended September 30, 2017

We had revenues of \$329 thousand for the nine months ended September 30, 2018, compared with \$327 thousand in revenues during the nine months ended September 30, 2017. We incurred a net loss of \$18.2 million in the nine months ended September 30, 2018, compared with a \$26.8 million net loss during the nine months ended September 30, 2017. The higher year to date net loss in 2017 was primarily due to a \$3.5 million loss on extinguishment of debt and a recorded liability of \$3.9 million related to other closing costs associated with the Senior Secured Debt financing (see "Liquidity and Capital Resources", below). The higher 2017 loss was also related to approximately \$1.7 million in stock compensation related to the vesting of milestone shares earned by employees.

Revenues We had revenues of \$329 thousand during the nine months ended September 30, 2018, and \$327 thousand during the nine months ended September 30, 2017. Revenues are primarily related to rental income from the FVF Lease (see "Agricultural Development", above).

General and Administrative Expenses General and administrative expenses, exclusive of stock-based compensation costs, totaled \$7.0 million in the nine months ended September 30, 2018, compared with \$6.7 million for the nine months ended September 30, 2017.

Compensation costs from stock and option awards for the nine months ended September 30, 2018, totaled \$0.4 million compared with \$2.0 million for the nine months ended September 30, 2017. The higher 2017 expense primarily reflects the vesting of milestone shares earned by employees.

Depreciation Depreciation expense totaled \$194 thousand for the nine months ended September 30, 2018, and \$212 thousand for the nine months ended September 30, 2017.

Interest Expense, net Net interest expense totaled \$11.2 million during the nine months ended September 30, 2018, compared to \$14.7 million during the same period in 2017. The following table summarizes the components of net interest expense for the two periods (in thousands):

	Nine Months Ended September 30,	
	2018	2017
Interest on outstanding debt	\$9,351	\$8,224
Unrealized (gain)/loss on warrants, net	(1,268 )	3,562
Amortization of debt discount	3,002	2,730
Amortization of deferred loan costs	82	146
	\$11,167	\$14,662

Interest Income Interest income totaled \$157 thousand for the nine months ended September 30, 2018, compared to \$9 thousand for the nine months ended September 30, 2017.

Income Taxes Income tax expense was \$4 thousand for the nine months ended September 30, 2018, compared to \$3 thousand for the nine months ended September 30, 2017. See Note 4 to the Consolidated Financial Statements – "Income Taxes".

### Liquidity and Capital Resources

#### Current Financing Arrangements

As we have not received significant revenues from our development activities to date, we have been required to obtain financing to bridge the gap between the time water resource and other development expenses are incurred and the time that revenue will commence. Historically, we have addressed these needs primarily through secured debt financing arrangements, private equity placements and the exercise of outstanding stock options and warrants. We have also worked with our secured lenders to structure our debt in a way which allows us to continue development of the Water Project and minimize the dilution of the ownership interests of common stockholders.

In March 2018, we entered into an At Market Issuance Sales Agreement with B. Riley FBR, Inc., under which the Company could issue and sell shares of its common stock having an aggregate offering price of up to \$15 million from time to time in an "at the market" offering (the "ATM Offering") through B. Riley FBR acting as its sales agent. We completed the offering during May 2018 having issued 1,159,718 shares of common stock in the ATM Offering for gross proceeds of \$15 million and aggregate net proceeds of approximately \$14.6 million.

In May 2017, we entered into a new \$60 million credit agreement with funds affiliated with Apollo Global Management, LLC ("Apollo") that replaced and refinanced our then existing \$45 million senior secured mortgage debt and provided \$15 million of new senior debt to fund immediate construction related expenditures ("Senior Secured Debt").

The Senior Secured Debt and the convertible notes contain representations, warranties and covenants that are typical for agreements of this type, including restrictions that would limit our ability to incur additional indebtedness, incur liens, pay dividends or make restricted payments, dispose of assets, make investments and merge or consolidate with another person. However, while there are affirmative covenants, there are no financial maintenance covenants and no restrictions on our ability to issue additional common stock to fund future working capital needs. The debt covenants associated with the Senior Secured Debt were negotiated by the parties with a view towards our operating and financial condition as it existed at the time the agreements were executed. At September 30, 2018, we were in compliance with our debt covenants.



The Company's cash resources provide us with sufficient funds to meet our working capital needs for a period beyond one year from this quarterly report issuance date. Additionally, we have principal and interest payments aggregating approximately \$80.3 million coming due in March 2020 related to our Convertible Senior Notes to the extent the noteholders, who have the right to convert at any time into our common stock at a conversion rate of \$6.75 per share, do not convert prior to March 2020. Our Senior Secured Debt of approximately \$65.1 million as of September 30, 2018, could also become due as early as December 2019, if the Convertible Senior Notes have not been converted by that time and the Company's stock price is less than 120% of the conversion rate and according to additional terms of the debt agreement as further disclosed in our 2017 Form 10-K.

Limitations on our liquidity and ability to raise capital may adversely affect us. Sufficient liquidity is critical to meet our resource development activities. We currently expect our cash on hand to be sufficient to meet our working capital needs for a period beyond one year from this quarterly report issuance date. To the extent additional capital is required, we may increase liquidity through a variety of means, including equity or debt placements, through the lease, sale or other disposition of assets or reductions in operating costs. Equity placements would be undertaken only to the extent necessary, so as to minimize the dilutive effect of any such placements upon our existing stockholders.

As we continue to actively pursue our business strategy, additional financing may continue to be required. See "Outlook" below. The covenants in the term debt do not prohibit our use of additional equity financing and allow us to retain 100% of the proceeds of any equity financing. We do not expect the loan covenants to materially limit our ability to finance our water development activities.

At September 30, 2018, we had no outstanding credit facilities other than the Senior Secured Debt and the convertible notes.

Cash Used in Operating Activities. Cash used in operating activities totaled \$8.6 million and \$7.7 million for the nine months ended September 30, 2018 and 2017, respectively. The cash was primarily used to fund general and administrative expenses related to our water development efforts for the nine-month periods ended September 30, 2018 and 2017.

Cash Used in Investing Activities. Cash used in investing activities totaled \$1.3 million for the nine months ended September 30, 2018, and \$671 thousand for the nine months ended September 30, 2017. The costs primarily consisted of engineering and design related to the development of the Water Project.

Cash Provided by Financing Activities. Cash provided by financing activities for the nine months ended September 30, 2018 was \$14.5 million compared to \$12.3 million for the nine months ended September 30, 2017. The 2018 amount includes \$14.6 million of net proceeds from the issuance of stock in an ATM Offering. The 2017 amount includes \$12.3 million of net proceeds from the issuance of long term debt.

## Outlook

**Short-Term Outlook.** Our cash resources of \$17.7 million as of September 30, 2018 provide us sufficient funds to meet our short term working capital needs. As we require additional working capital to fund operations, we expect to continue our historical practice of structuring our financing arrangements to match the anticipated needs of our development activities. No assurances can be given, however, as to the availability or terms of any new financing. See "Long-Term Outlook", below. Further, our option to acquire an additional 124-mile extension of our Northern Pipeline will require a \$20 million payment by December 2018. We do not currently have the cash resources on hand to exercise this option and have engaged an investment banker to pursue alternatives intended to provide the resources to allow us to exercise this option. If we are unable to exercise this option, then our Northern Pipeline opportunities will be limited to the 96-mile segment we currently own.

**Long-Term Outlook.** In the longer term, we may need to raise additional capital to finance working capital needs, capital expenditures and any payments due under our Senior Secured Debt or our convertible notes at maturity (see "Current Financing Arrangements", above). Our future working capital needs will depend upon the specific measures we pursue in the entitlement and development of our water resources and other developments. Future capital expenditures will depend primarily on the progress of the Water Project.

We are evaluating the amount of cash needed, and the manner in which such cash will be raised, on an ongoing basis. We may meet any future cash requirements through a variety of means, including equity or debt placements, or through the sale or other disposition of assets. Equity placements would be undertaken only to the extent necessary, so as to minimize the dilutive effect of any such placements upon our existing stockholders. Limitations on our liquidity and ability to raise capital may adversely affect us. Sufficient liquidity is critical to meet our resource development activities.

## Recent Accounting Pronouncements

See Note 1 to the Condensed Consolidated Financial Statements – "Basis of Presentation".

## ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

We are a smaller reporting company as defined by Reg. 240.12b-2 of the Securities and Exchange Act of 1934 and are not required to provide the information under this item.



ITEM 4. Controls and Procedures

Disclosure Controls and Procedures

The Company established disclosure controls and procedures to ensure that material information related to the Company, including its consolidated entities, is accumulated and communicated to senior management, including the Chief Executive Officer (the "Principal Executive Officer") and Chief Financial Officer (the "Principal Financial Officer") and to its Board of Directors. Based on their evaluation as of September 30, 2018, the Company's Principal Executive Officer and Principal Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and such information is accumulated and communicated to management, including the principal executive and principal financial officers as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Controls Over Financial Reporting

In connection with the evaluation required by paragraph (d) of Rule 13a-15 under the Exchange Act, there was no change identified in the Company's internal controls over financial reporting that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

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PART II - OTHER INFORMATION

ITEM 1. Legal Proceedings

Not applicable.

ITEM 1A. Risk Factors

We are a smaller reporting company as defined by Reg. 240.12b-2 of the Securities and Exchange Act of 1934 and are not required to provide the information under this item.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable.

**ITEM 3. Defaults Upon Senior Securities**

Not applicable.

**ITEM 4. Mine Safety Disclosures**

Not applicable.

**ITEM 5. Other Information**

Not applicable.

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ITEM 6. Exhibits

The following exhibits are filed or incorporated by reference as part of this Quarterly Report on Form 10-Q.

- 31.1 Certification of Scott S. Slater, Chief Executive Officer of Cadiz Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Timothy J. Shaheen, Chief Financial Officer and Secretary of Cadiz Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Scott S. Slater, Chief Executive Officer of Cadiz Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Timothy J. Shaheen, Chief Financial Officer and Secretary of Cadiz Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Cadiz Inc.

By: <u>/s/ Scott S. Slater</u>	<u>November 8, 2018</u>
Scott S. Slater	Date
Chief Executive Officer and President	
(Principal Executive Officer)	

By: <u>/s/ Timothy J. Shaheen</u>	<u>November 8, 2018</u>
Timothy J. Shaheen	Date
Chief Financial Officer and Secretary	
(Principal Financial Officer)	