

PURE CYCLE CORP  
Form 10-K  
October 28, 2016

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended August 31, 2016

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 0-8814

PURE CYCLE  
CORPORATION  
(Exact name of  
registrant as  
specified in its  
charter)

Colorado  
(State or other jurisdiction of incorporation  
or organization)

84-0705083  
(I.R.S. Employer Identification No.)

34501 E. Quincy Ave., Bldg. 34, Box 10  
Watkins, CO 80137  
(Address of principal executive offices) (Zip Code)

(303) 292-3456  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock 1/3 of \$.01 par value  
(Title of each class)

The NASDAQ Stock Market, LLC  
(Name of each exchange on which registered)

Securities registered  
pursuant to Section  
12(g) of the Act: NONE

Indicate by check mark  
if the registrant is a  
well-known seasoned  
issuer, as defined in  
Rule 405 of the  
Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

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 website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section

229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

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

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed

second fiscal quarter:

\$78,578,883

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date:

October 27, 2016:

23,754,098

**DOCUMENTS  
INCORPORATED BY  
REFERENCE**

The information required by Part III is incorporated by reference from the registrant's definitive proxy statement for the Annual Meeting of Shareholders to be held in January 2017, which will be filed with the SEC within 120 days of the close of the fiscal year ended August 31, 2016.



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## FORWARD-LOOKING STATEMENTS

Statements that are not historical facts contained in this Annual Report on Form 10-K, or incorporated by reference into this Form 10-K, are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). The words “anticipate,” “seek,” “project,” “future,” “likely,” “believe,” “may,” “should,” “could,” “will,” “estimate,” “expect,” “plan,” “intend” and similar expressions, as they relate to us, are intended to identify forward-looking statements. Forward-looking statements include statements relating to, among other things:

factors affecting demand for water;

our competitive advantage;

plans to develop additional water assets within the Denver area;

future water supply needs in Colorado and how such needs will be met;

anticipated increases in residential and commercial demand for water services and competition for these services;

estimated population increases in the Denver metropolitan area and the South Platte River basin;

plans for the use and development of our water assets and potential delays;

plans to provide water for drilling and hydraulic fracturing of oil and gas wells;

changes in oil and gas drilling activity on our property and on the Lowry Range;

regional cooperation among area water providers in the development of new water supplies and water storage, transmission and distribution systems as the most cost-effective way to expand and enhance service capacities;

the impact of individual housing and economic cycles on the number of connections we can serve with our water;

increases in future water tap fees;

negotiation of payment terms for fees;

plans for development of our Sky Ranch property;

the number of units planned for the first phase of development at Sky Ranch;

anticipated revenues from full development of our Sky Ranch property;

the impact of the downturn in the homebuilding and credit markets on our business and financial condition;

the sufficiency of our working capital and financing sources to fund our operations;

estimated supply capacity of our water assets;

need for additional production capacity;

use of raw and reclaimed water for outdoor irrigation;

costs and plans for treatment of water and wastewater;

plans to use effluent water for agricultural and irrigation uses;

participation in regional water projects, including “WISE” and the timing and availability of water from WISE;

our ability to assist Colorado “Front Range” water providers in meeting current and future water needs;

timing of and interpretation of Land Board royalties;

the number of new water connections needed to recover the costs of our water supplies;

the adequacy of the provisions in the “Lease” for the Lowry Range to cover present and future circumstances;

plans for office space;

factors that may impact labor and material costs;

loss of key employees and hiring additional personnel for our operations;

anticipated timing and amount of, and sources of funding for (i) capital expenditures to construct infrastructure and increase production capacities, (ii) compliance with water, environmental and other regulations, and (iii) operations including delivery and treatment of water and wastewater;

the ability of our deep water well enhancement tool and process to increase efficiency of wells and our plans to market that product to area water providers;

our ability to reduce the amount of up-front construction costs for water and wastewater systems;

ability to generate working capital and market our water assets;



plans to sell certain farms and recover the costs associated with acquiring those farms;

service life of constructed facilities;

use of third parties to construct facilities required to extend water and wastewater services;

payment of amounts due from Rangeview Metropolitan District and Sky Ranch Metropolitan District #5;

estimated property taxes;

utilization of net operating losses;

capital expenditures for investing in expenses and assets of the District;

the impact of water quality, solid waste disposal and environmental regulations on our financial condition and results of operations;

environmental clean-up at the Lowry Range by the U.S. Army Corps of Engineers;

our ability to comply with permit requirements and environmental regulations and the cost of such compliance;

our ability to meet customer demands in a sustainable and environmentally friendly way;

the recoverability of construction and acquisition costs from rates;

our belief that we are not a public utility under Colorado law;

our belief that we are not an investment company under the Investment Company Act of 1940, as amended;

impairments in carrying amounts of long-lived assets;

changes in unrecognized tax positions;

plans to retain earnings and not pay dividends;

forfeitures of option grants, vesting of non-vested options and the fair value of option awards;

the effectiveness of our disclosure controls and procedures and our internal controls over financial reporting;

accounting estimates and the impact of new accounting pronouncements;

future fluctuations in the price and trading volume of our common stock; and

timing of the filing of our proxy statement.

Forward-looking statements reflect our current views with respect to future events and are subject to certain risks, uncertainties and assumptions. We cannot assure you that any of our expectations will be realized. Our actual results could differ materially from those in such statements. Factors that could cause actual results to differ from those contemplated by such forward-looking statements include, without limitation:

the timing of new home construction and other development in the areas where we may sell our water, which in turn may be impacted by credit availability;

population growth;

employment rates;

timing of oil and gas development in the areas where we sell our water;

general economic conditions;

the market price of water;

the market price of oil and gas;

changes in customer consumption patterns;

changes in applicable statutory and regulatory requirements;

changes in governmental policies and procedures;

changes in interest rates;

uncertainties in the estimation of water available under decrees;

uncertainties in the estimation of costs of delivery of water and treatment of wastewater;

uncertainties in the estimation of the service life of our systems;

uncertainties in the estimation of costs of construction projects;

the strength and financial resources of our competitors;

our ability to find and retain skilled personnel;

climatic and weather conditions, including floods, droughts and freezing conditions;

labor relations;

turnover of elected and appointed officials and delays caused by political concerns and government procedures;



availability and cost of labor, material and equipment;

delays in anticipated permit and construction dates;

engineering and geological problems;

environmental risks and regulations;

our ability to raise capital;

our ability to negotiate contracts with new customers;

uncertainties in water court rulings; and

the factors described under “Risk Factors” in this Annual Report on Form 10-K.

We undertake no obligation, and disclaim any obligation, to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. All forward-looking statements are expressly qualified by this cautionary statement.

## PART I

### Item 1 – Business

Pure Cycle Corporation (“we,” “us” or “our”) is a Colorado corporation that provides wholesale water and wastewater services. The wholesale water and wastewater services may include, but are not limited to, water production, storage, treatment, bulk transmission to retail distribution systems, wastewater collection and treatment, irrigation water treatment and transmission, construction management, billing and collection, and emergency response. We provide these services to our wholesale customers, which are typically industrial customers and local governmental entities that provide water and wastewater services to their end-use customers located in the greater Denver, Colorado metropolitan area.

We are a vertically integrated water company, which means we own or control substantially all assets necessary to provide wholesale water and wastewater services to our customers. This includes owning (i) water rights which we use to provide domestic and irrigation water to our wholesale customers (we own surface water, groundwater, reclaimed water rights and water storage rights), (ii) infrastructure (such as wells, diversion structures, pipelines, reservoirs and treatment facilities) required to withdraw, treat, store and deliver water, (iii) infrastructure required to collect, treat, store and reuse wastewater, and (iv) infrastructure required to treat and deliver reclaimed water for irrigation use.

We currently provide wholesale water service predominantly to two local governmental entity customers. Our largest customer is the Rangeview Metropolitan District (the “District”), a quasi-municipal political subdivision of the State of Colorado which is described further below. We provide service to the District and its end-use customers pursuant to the “Rangeview Water Agreements” (defined below) between us and the District for the provision of wholesale water service to the District for use in the District’s service area. Through the District, we provide wholesale service to 258 Single Family Equivalent (“SFE”) (defined below) water connections and 157 SFE wastewater connections located in southeastern metropolitan Denver. In the past three years, we have been providing untreated water to industrial customers in our service areas and adjacent to our service areas to the oil and gas industry for the purpose of hydraulic fracturing. Oil and gas operators have leased more than 135,000 acres within and adjacent to our service areas for the purpose of exploring oil and gas interests in the Niobrara and other formations, and this activity in the past has led to increased water demands. As a result of decreased oil prices, oil and gas operators have curtailed their drilling since 2014.

We plan to utilize our significant water assets along with our adjudicated reservoir sites, which are described in the Our Water and Land Assets section below, to provide wholesale water and wastewater services to local governmental entities. These local governmental entities will in turn provide residential and commercial water and wastewater

services to communities along the eastern slope of Colorado in the area extending essentially from Fort Collins on the north to Colorado Springs on the south which is generally referred to as the “Front Range.” Principally we are targeting the “I-70 corridor” which is located east of downtown Denver and south of Denver International Airport along Interstate 70. This area is predominately undeveloped and is expected to experience substantial growth over the next 30 years. We also own 931 acres of land in the I-70 corridor known as Sky Ranch, which we are planning for development. Sky Ranch is described in the Our Water and Land Assets section below.

Pure Cycle Corporation was incorporated in Delaware in 1976 and reincorporated in Colorado in 2008.



## Glossary of terms

The following terms are commonly used in the water industry and are used throughout our annual report:

**Acre Foot** – approximately 326,000 gallons of water, or enough water to cover an acre of ground with one foot of water. For some instances herein, as context dictates, the term acre feet is used to designate an annual decreed amount of water available during a typical year.

**Customer Facilities** – facilities that carry potable water and reclaimed water to customers from the retail water distribution system (see “Retail Facilities” below) and collect wastewater from customers and transfer it to the retail wastewater collection system. Water and wastewater service lines, interior plumbing, meters and other components are typical examples of Customer Facilities. In many cases, portions of the Customer Facilities are constructed by the developer. Customer Facilities are typically owned and maintained by the customer.

**Non-Tributary Groundwater** – underground water in an aquifer that is situated so it neither draws from nor contributes to a natural surface stream in any measurable degree.

**Not Non-Tributary Groundwater** – statutorily defined as groundwater located within those portions of the Dawson, Denver, Arapahoe, and Laramie-Fox hills aquifers that are outside of any designated groundwater basin in existence on January 1, 1985.

**Retail Facilities** – facilities that distribute water to and collect wastewater from an individual subdivision or community. Developers are typically responsible for the funding and construction of Retail Facilities. Once we certify that the Retail Facilities have been constructed in accordance with our design criteria, the developer dedicates the Retail Facilities to a quasi-municipal political subdivision of the state, and we operate and maintain the facilities on behalf of such political subdivision.

**Section** – a parcel of land equal to one square mile and containing 640 acres.

**Single Family Equivalent unit (“SFE”)** – One SFE is a customer – whether residential, commercial or industrial – that imparts a demand on our water or wastewater systems similar to the demand of a family of four persons living in a single family house on a standard sized lot. One SFE is assumed to have a water demand of approximately 0.4 acre feet per year and to contribute wastewater flows of approximately 300 gallons per day.

**Special Facilities** – facilities that are required to extend services to an individual development and are not otherwise classified as a typical “Wholesale Facility” or “Retail Facility.” Temporary infrastructure required prior to construction of permanent water and wastewater systems or transmission pipelines to transfer water from one location to another are examples of Special Facilities. We typically design and construct the Special Facilities using funds provided by the developer in addition to the normal rates, fees and charges that we collect from our customers. We are typically responsible for the operation and maintenance of the Special Facilities upon completion.

Tributary Groundwater – all water located in an aquifer that is hydrologically connected to a natural stream such that depletion has an impact on the surface stream.

Tributary Surface Water – water on the surface of the ground flowing in a stream or river system.

Wholesale Facilities – facilities that serve an entire service area or major regions or portions thereof. Wells, treatment plants, pump stations, tanks, reservoirs, transmission pipelines, and major sewage lift stations are typical examples of Wholesale Facilities. We own, design, construct, operate, maintain and repair Wholesale Facilities which are typically funded using rates, fees and charges that we collect from our customers.



Our Water and Land Assets

This section should be read in conjunction with Item 1A – Risk Factors, Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Use of Estimates, and Note 4 – Water and Land Assets.

The \$28.3 million of capitalized water costs on our balance sheet represents the costs of the water rights we own or have the exclusive right to use and the related infrastructure developed to provide wholesale water and wastewater services. Our water assets are as follows:

Table A - Water Assets

Water Source	Groundwater (acre feet)
Lowry (Rangeview Water Supply)	
Export (1)	11,650
Non-Export (1)	12,035
Fairgrounds	321
Sky Ranch	828
	24,834
	Surface Water (acre feet)
Lowry (1)	3,300
WISE	500
	3,800
Total (Groundwater and Surface Water)	28,634

(1) The combined Lowry water rights are 26,985.

We believe we can serve approximately 60,000 SFEs.

Our service areas and water and land assets are described in greater detail in the maps and discussion that follows:



The map below indicates the location of our Denver area assets.

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## Rangeview Water Supply and the Lowry Range

Our Rangeview Water – We own or control a total of approximately 3,300 acre feet of tributary surface water, 23,685 acre feet of non-tributary and not non-tributary groundwater rights, and approximately 26,000 acre feet of adjudicated reservoir sites that we refer to as our “Rangeview Water Supply.” This water is located in the southeast Denver metropolitan area at the “Lowry Range,” which is owned by the State Board of Land Commissioners (the “Land Board”) and is described below.

We acquired our Rangeview Water Supply in April 1996 pursuant to the following agreements:

- (i) The 1996 Amended and Restated Lease Agreement between the Land Board and the District which was superseded by the 2014 Amended and Restated Lease Agreement, dated July 10, 2014 (the “Lease”), among the Land Board, the District, and us;
- (ii) The Agreement for Sale of non-tributary and not non-tributary groundwater which we can “export” from the Lowry Range to supply water to nearby communities (this portion of the Rangeview Water Supply is referred to as our “Export Water”) between us and the District (the “Export Agreement”); and
- (iii) The 1996 Service Agreement between us and the District for the provision of water service to the District’s customers, which was superseded by the Amended and Restated Service Agreement, dated July 11, 2014 (the “Service Agreement”), between us and the District.

Additionally, in 1997 we entered into a Wastewater Service Agreement (the “Wastewater Agreement”) with the District to provide wastewater service to the District’s customers.

The Lease, the Export Agreement, the Service Agreement, and the Wastewater Agreement are collectively referred to as the “Rangeview Water Agreements.”

Pursuant to the Rangeview Water Agreements, we design, construct, operate and maintain the District’s water and wastewater systems to allow the District to provide water and wastewater service to its customers located within the District’s 24,000 acre service area at the Lowry Range. Subject to the terms and conditions of the Lease, we are the exclusive water and wastewater provider on the Lowry Range, and we operate both the water and the wastewater systems during our contract period on behalf of the District, which owns the facilities for both systems. At the expiration of our contract term in 2081, ownership of the water system facilities located on the Lowry Range used to deliver Non-Export Water to customers will revert to the Land Board, with the District retaining ownership of the wastewater facilities. Through facilities we own, we use our Export Water, and we intend to use other supplies owned by us, to provide wholesale water service and wastewater service to customers located outside of the Lowry Range, including customers of the District and other governmental entities and industrial and commercial customers. Of the approximately 26,985 acre feet of water comprising our Rangeview Water Supply, we own 11,650 acre feet of Export Water, which consists of 10,000 acre feet of groundwater and 1,650 acre feet of average yield surface water, pending completion by the Land Board of documentation related to the exercise of our right to substitute 1,650 acre feet of our groundwater for a comparable amount of surface water. Additionally, assuming the completion of the substitution of groundwater for surface water, we hold the exclusive right to develop and deliver through the year 2081 the remaining 12,035 acre feet of groundwater and approximately 1,650 acre feet of average yield surface water to customers either on or off of the Lowry Range.

The Lowry Range Property – The Lowry Range is located in unincorporated Arapahoe County, about 20 miles southeast of downtown Denver. The Lowry Range is one of the largest contiguous parcels under single ownership next to a major metropolitan area in the United States. The Lowry Range is approximately 27,000 acres in size or about 40 square miles of land. Of the 27,000 acres, pursuant to our agreements with the Land Board and the District,

we have the exclusive rights to provide water and wastewater services to approximately 24,000 acres of the Lowry Range.

Rangeview Metropolitan District – The District is a quasi-municipal corporation and political subdivision of Colorado formed in 1986 for the purpose of providing water and wastewater service to the Lowry Range and other approved areas. The District is governed by an elected board of directors. Eligible voters and persons eligible to serve as directors of the District must own an interest in property within the boundaries of the District. We own certain rights and real property interests which encompass the current boundaries of the District. The current directors of the District are Mark W. Harding, Scott E. Lehman, and David A. Garin (all are employees of Pure Cycle), and two independent board members. Pursuant to Colorado law, directors may receive \$100 for each board meeting they attend, up to a maximum of \$1,600 per year. Mr. Harding, Mr. Lehman, and Mr. Garin have all elected to forego these payments.

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South Metropolitan Water Supply Authority (“SMWSA”) and Water Infrastructure Supply Efficiency Partnership (“WISE”) – SMWSA is a municipal water authority in the State of Colorado organized to pursue the acquisition and development of new water supplies on behalf of its members, including the District. SMWSA members include 14 Denver area water providers in Arapahoe and Douglas Counties. The District became a member of SMWSA in 2009 in an effort to participate with other area water providers in developing regional water supplies along the Front Range. We entered into a Participation Agreement with the District on December 16, 2009, whereby we agreed to provide funding to the District in connection with its membership in the SMWSA (the “SMWSA Participation Agreement”). SMWSA members have been working with the City and County of Denver acting through its Board of Water Commissioners (“Denver Water”) and the City of Aurora acting by and through its Utility Enterprise (“Aurora Water”) on a cooperative water project known as the WISE, which seeks to develop regional infrastructure that would interconnect members’ water transmission systems to be able to develop additional water supplies from the South Platte River in conjunction with Denver Water and Aurora Water. In July 2013, the District together with nine other SMWSA members formed the South Metro WISE Authority (“SMWA”) pursuant to the South Metro WISE Authority Formation and Organizational Intergovernmental Agreement (the “SM IGA”) to enable its members to participate in WISE. The SM IGA specifies each member’s pro rata share of WISE and the members’ rights and obligations with respect to WISE. On December 31, 2013, SMWA, Denver Water and Aurora Water entered into the Amended and Restated WISE Partnership – Water Delivery Agreement (the “WISE Partnership Agreement”), which provides for the purchase and construction of certain infrastructure (pipelines, water storage facilities, water treatment facilities, and other appurtenant facilities) to deliver water to and among the 10 members of the SMWA, Denver Water and Aurora Water. We have entered into the Rangeview/Pure Cycle WISE Project Financing Agreement with the District dated November 19, 2014 (effective as of December 22, 2014), which obligates us to fund the District’s cost of participating in WISE (the “WISE Financing Agreement”). In exchange for funding the District’s obligations in WISE, we will have the sole right to use and reuse the District’s approximate 7% share of the WISE water and infrastructure to provide water service to the District’s customers and to receive the revenue from such service. Upon completion of the WISE infrastructure in 2017, we will be entitled to approximately three million gallons per day of transmission pipeline capacity and 500 acre feet per year of water. In accordance with the WISE Financing Agreement and the SMWSA Participation Agreement, to date we have provided approximately \$2.9 million of financing to the District to fund its obligation to finance the purchase of infrastructure for WISE, its obligations related to SMWSA, and the construction of a connection to the WISE system. We anticipate that we will be spending the following over the next five fiscal years to fund the District’s purchase of its share of the water transmission line and additional facilities, water and related assets for WISE and to fund operations and water deliveries related to WISE:

Table B - Estimated WISE Costs

	For the Fiscal Years Ended August 31,				
	2017	2018	2019	2020	2021
Operations	\$96,600	\$96,600	\$96,600	\$96,600	\$96,600
Water Delivery	45,000	225,000	495,000	675,000	855,000
Capital	464,000	339,000	464,000	1,339,200	57,100
Other	43,500	23,600	86,600	23,600	23,600
	\$649,100	\$684,200	\$1,142,200	\$2,134,400	\$1,032,300

Land Board Royalties – Pursuant to the Rangeview Water Agreements, the Land Board is entitled to royalty payments based on a percentage of revenues earned from water sales that utilize water from the Rangeview Water Supply. The calculation of royalties depends on the water source and whether the customer is a public or private entity. Royalties were modified in July 2014 pursuant to the terms of the Lease. The Land Board does not receive a royalty from

wastewater services.

Water Customers – When we develop, operate and deliver water service, payments from customers generate royalties to the Land Board at a rate of 12% of gross revenues from private customers and 10%

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from public entity customers. In the event that either (i) metered production of water used on the Lowry Range in any calendar year exceeds 13,000 acre feet or (ii) 10,000 surface acres on the Lowry Range have been rezoned to non-agricultural use, finally platted and water tap agreements have been entered into with respect to all improvements to be constructed on such acreage, the Land Board may elect, at its option, to receive, in lieu of its royalty of 10% or 12% of gross revenues (depending on whether the customer is public or private), 50% of the collective net profits (ours and the District's) derived from the sale or other disposition of water on the Lowry Range. To date neither of these conditions has been met, and such conditions are not likely to be met any time soon. In addition to royalties on the sale of metered water deliveries, the Land Board will receive a royalty on the sale of water taps at the rate of two percent, except for the sale of any taps to Sky Ranch, of the gross amount received from the sale of a water tap.

Sale of Water Rights – In the event we sell our Export Water right outright rather than developing and delivering water service, royalties to the Land Board escalate based on the amount of gross revenue we receive and are lower for sales to a water district or similar municipal or public entity than for sales to a private entity as noted in Table C.

Table C- Royalties for Sale of Export Water Rights

Gross Revenues	Royalty Rate	
	Private Entity Buyer	Public Entity Buyer
\$0 - \$45,000,000	12%	10%
\$45,000,001 - \$60,000,000	24%	20%
\$60,000,001 – \$75,000,000	36%	30%
\$75,000,001 - \$90,000,000	48%	40%
Over \$90,000,000	50%	50%

We are also required to pay the Land Board a minimum annual water production fee, which is currently under negotiation, but we have estimated the minimum fee to be approximately \$45,600 per year, which is to be credited against future royalties.

East Cherry Creek Valley System – Pursuant to a 1982 contractual right, the District may purchase water produced from East Cherry Creek Valley Water and Sanitation District's ("ECCV") Land Board system. ECCV's Land Board system is comprised of eight wells and more than 10 miles of buried water pipeline located on the Lowry Range. In May 2012, in order to increase the delivery capacity and reliability of these wells, in our capacity as the District's service provider and the Export Water Contractor (as defined in the Lease among us, the District and the Land Board), we entered into an agreement to operate and maintain the ECCV facilities allowing us to utilize the system to provide water to commercial and industrial customers, including customers providing water for drilling and hydraulic fracturing of oil and gas wells. Our costs associated with the use of the ECCV system are a flat monthly fee of \$8,000 per month from January 1, 2013 through December 31, 2020, and will decrease to \$3,000 per month from January 1, 2021 through April 2032. Additionally, we pay a fee per 1,000 gallons of water produced from ECCV's system, which is included in the water usage fees charged to customers.

Hydraulic Fracturing – Water revenues from sales of water for the development of well sites and for drilling and fracking wells drilled into the Niobrara Formation were approximately \$600 and \$782,700 during the fiscal years ended August 31, 2016 and 2015, respectively. With a large percentage of the acreage surrounding the Lowry Range in Arapahoe, Adams, Elbert, and portions of Douglas Counties already leased by major oil companies, we anticipate

providing additional water for drilling and hydraulic fracturing (“fracking”) of oil and gas wells in the future. Through March 2015, we sold untreated water directly to ConocoPhillips Company (“ConocoPhillips”), the largest oil and gas lease holder operating in the area, and indirectly to ConocoPhillips through Select Energy Services, LLC (“Select”). As a result of low oil prices, drilling in our service has been curtailed and sales have been limited during the current fiscal year.



#### Arapahoe County Fairgrounds Agreement for Water Service

In 2005, we entered into an Agreement for Water Service (the “County Agreement”) with Arapahoe County to design, construct, operate and maintain a water system for, and provide water services to, the county for use at the Arapahoe County fairgrounds (the “Fairgrounds”), which are located west of the Lowry Range. Pursuant to the County Agreement, we purchased 321 acre feet of water from the county in 2008. Further details of the arrangements with the county are described in Note 4 – Water and Land Assets to the accompanying financial statements.

Pursuant to the County Agreement, we constructed and own a deep water well, a 500,000-gallon water tank and pipelines to transport water to the Fairgrounds. The construction of these items was completed in our fiscal 2006, and we began providing water service to the county in 2006.

#### Sky Ranch

In 2010, we purchased approximately 931 acres of undeveloped land located in unincorporated Arapahoe County known as Sky Ranch. Sky Ranch is located directly adjacent to I-70, 16 miles east of downtown Denver, four miles north of the Lowry Range, and four miles south of Denver International Airport.

The property includes rights to approximately 830 acre feet of water and approximately 640 acres of oil and gas mineral rights and has been zoned for residential, commercial and retail uses that may include up to 4,850 SFEs. Sky Ranch is zoned for 4,400 homes and 1.35 million square feet of commercial and retail property. There is currently no development at Sky Ranch. We currently lease the land to an area farmer and have leased the minerals to ConocoPhillips. We envision that when development at Sky Ranch begins, the development will be in the form of entry-level housing (houses costing in the \$300,000 range).

We are currently working on plans to develop the first phase of Sky Ranch which will include 151 acres. The plan for the first phase of the development will include 502 units but, depending on lot size and configuration, may be increased to 525 units.



We plan to provide wholesale and wastewater services to one or more Sky Ranch metropolitan districts (the “Sky Ranch District”) that will in turn provide retail water and wastewater services to the Sky Ranch District residents and businesses. We anticipate we will need to construct infrastructure such as roads, curbs and gutters, and the necessary water and wastewater systems; however, we are in discussions with a number of developers and builders to determine how this infrastructure will be phased and financed. Our plan is to provide the market with competitively priced lots that are ready for development, together with affordable, sustainable, environmentally sound water and wastewater services. We currently anticipate development will begin in the second half of calendar 2017 subject to us obtaining the necessary approvals and the timing of the final design. We anticipate the development of the first phase to occur over a number of sub-phases with multiple builders, and we are targeting approximately 100 lots per year being developed. At full development, the water and wastewater utilities at Sky Ranch are anticipated to generate in excess of \$145 million in tap fee revenue and approximately \$7.5 million annually in wholesale water and wastewater service fee revenue (based on current fees and charges).

Oil and Gas Lease – On March 10, 2011, we entered into a Paid-Up Oil and Gas Lease (the “O&G Lease”) and Surface Use and Damage Agreement (the “Surface Use Agreement”) with Anadarko E&P Company, L.P. (“Anadarko”), a wholly owned subsidiary of Anadarko Petroleum Company. The O&G Lease seeks to capitalize on the growing interest in the region’s Niobrara Oil Formation. Pursuant to the O&G Lease, we received an up-front payment of \$1,900 per net mineral leased acre, or \$1,243,400, and 20% of gross proceeds royalty (less certain taxes) from the sale of any oil and gas produced from our property. In December 2012, the O&G Lease was purchased by a wholly owned subsidiary of ConocoPhillips. The O&G Lease had a term of three (3) years commencing on March 10, 2011. The lease was extended for an additional two (2) years, and we received an additional up-front payment of \$1,243,400 for the extension. The O&G Lease is now held by production entitling us to royalties



instead of renewal payments. Pursuant to the Surface Use Agreement, ConocoPhillips may drill on up to three well pad sites on the Sky Ranch property covered under the O&G Lease. Additionally, we will receive \$3,000 per acre for land that is permanently disturbed for use in the exploration and production of oil and gas. During fiscal 2015, two wells were drilled within our mineral interest. Beginning in March 2015, both wells were placed into service and began producing oil and gas and accruing royalties to us. In May 2015, certain gas collection infrastructure was extended to the property to allow the collection of gas from the wells and accrual of royalties attributable to gas production. During the fiscal year ended August 31, 2016, we received \$343,600 in royalties attributable to these two wells.

In the past, we experienced water demands for hydraulic fracturing of oil and gas wells being developed in the Niobrara Formation around our Sky Ranch property and the Land Board's Lowry Range property. These demands have been curtailed by the decline in oil prices. The wells developed in the Niobrara Formation that we have served were utilizing between seven and 12 million gallons of water to drill and frack, which equates to selling water to between approximately 53 and 92 SFEs for an entire year.

#### Arkansas River Land

During the fiscal quarter ended November 30, 2015, we purchased three farms totaling 700 acres for approximately \$450,300. The farms were acquired in order to correct dry-up covenant issues related to water only farms in order obtain the release of the escrow funds related to the Company's farm sale to Arkansas River Farms, LLC. We intend to sell the farms within the next fiscal year. We also own approximately 13,900 acres of mineral interests in the Arkansas River Valley, which have an estimated value of approximately \$1.4 million. We currently have no plans to sell our mineral interests.

#### Well Enhancement and Recovery Systems

In January 2007, we, along with two other parties, formed Well Enhancement and Recovery Systems LLC ("Well Enhancement LLC"), to develop a new deep water well enhancement tool and process that we believe will increase the efficiency of wells completed into the Denver Basin groundwater formations. In fiscal 2008, the well enhancement tool and process was completed and tested on two deep water wells developed by an area water provider with favorable results. According to results from studies performed by an independent hydro-geologist, the well enhancement tool effectively increased the production of the two test wells by 80% and 83% when compared to that of nearby wells developed in similar formations at similar depths. Based on the positive results of the test wells, we continue to refine the process of enhancing deep water wells and are marketing the tool to area water providers. On April 27, 2010, we and the other remaining owner of Well Enhancement LLC acquired the third partner's one-third interest in Well Enhancement LLC. Following the acquisition, the remaining partners each hold a 50% interest in Well Enhancement LLC. We used our tool on one well during fiscal 2014. We did not use our tool during either fiscal 2015 or fiscal 2016.

#### Revenues

We generate revenues through our wholesale water and wastewater segment predominately from three sources: (i) monthly service and contract delivery fees, (ii) one-time water and wastewater tap fees and construction fees, and (iii) consulting fees. Our revenue sources and how we account for them are described in greater detail below. We typically negotiate the payment terms for tap fees, construction fees, and other water and wastewater service fees with our wholesale customers as a component of our service agreements prior to construction of the project. However, with respect to customers on the Lowry Range, pursuant to the Lease, the District's rates and charges to such end-use customers may not exceed the average of similar rates and charges of three nearby water providers.

i.

Monthly Service Fees – Monthly wholesale water usage fees are assessed to our customers based on actual metered deliveries to their end-use customers each month. Water usage fees are based on a tiered pricing structure that provides for higher prices as customers use greater amounts of water. The water usage fees for end-use customers on the Lowry Range are noted below in Table D:



Table D - Tiered Water Usage Pricing Structure

Amount of consumption	Price (\$ per thousand gallons)		
	2016	2015	2014
Base charge per SFE	\$30.35	\$30.35	\$30.35
0 gallons to 10,000 gallons	\$3.51	\$3.51	\$3.51
10,001 gallons to 20,000 gallons	\$5.31	\$5.31	\$5.31
20,001 gallons to 40,000 gallons	\$8.12	\$8.12	\$8.12
40,001 gallons and above	\$9.55	\$9.55	\$9.55

The figures in Table D reflect the amounts charged to the District's end-use customers. In exchange for providing water service to the District's Lowry Range customers, we receive 98% of the usage charges received by the District relating to water services after deducting the required royalty to the Land Board (described above at Rangeview Water Supply and Lowry Range – Land Board Royalties). In exchange for providing wastewater services, we receive 90% of the District's monthly wastewater service fees, as well as the right to use or sell the reclaimed water.

The District's 2016 rates and charges for wastewater service are based on a monthly fee of \$10.05 per SFE plus a \$7.40 per thousand gallons treated usage fee.

In addition to the tiered water usage pricing structure, we currently charge a hydrant rate of \$10.50 per thousand gallons for commercial and industrial customers. We also collect other immaterial fees and charges from customers and other users to cover miscellaneous administrative and service expenses, such as application fees, review fees and permit fees.

ii.

Water and Wastewater Tap Fees and Construction Fees – Tap fees are typically paid by developers in advance of construction activities and are non-refundable. Tap fees are typically used to fund construction of the Wholesale Facilities and defray the acquisition costs of obtaining water rights.

The District's 2016 water tap fees are \$24,620, and its wastewater tap fees are \$4,988.

In exchange for providing water service to the District's customers on the Lowry Range, we receive 100% of the District's tap fees after deducting the required two percent royalty to the Land Board described above. In exchange for providing wastewater services, we receive 100% of the District's wastewater tap fees.

Construction fees are fees we receive, typically in advance, from developers for us to build certain infrastructure such as Special Facilities which are normally the responsibility of the developer.

iii.

Consulting Fees – Consulting fees are fees we receive, typically on a monthly basis, from municipalities and area water providers along the I-70 corridor, for systems with respect to which we provide contract operations services.

### Significant Customers

Our wholesale water and wastewater sales to the District pursuant to the Rangeview Water Agreements accounted for 67%, 19% and 9% of our total water revenues for the fiscal years ended August 31, 2016, 2015 and 2014, respectively. The District has one significant customer, the Ridgeview Youth Services Center (“Ridgeview”). Pursuant to our Rangeview Water Agreements with the District, we are providing water to Ridgeview on behalf of the District. Ridgeview accounted for 55%, 16% and 7% of our total water revenues for the fiscal years ended August 31, 2016, 2015 and 2014, respectively.

Our industrial water sales directly and indirectly to ConocoPhillips accounted for approximately less than 1%, 75% and 88% of our total water revenues for the fiscal years ended August 31, 2016, 2015 and 2014, respectively.



## Our Projected Operations

This section should be read in conjunction with Item 1A – Risk Factors.

Along the Colorado Front Range, there are over 70 water providers with varying needs for replacement and new water supplies. We believe we are well positioned to assist certain of these providers in meeting their current and future water needs.

We design, construct and operate our water and wastewater facilities using advanced water purification and wastewater treatment technologies which allow us to use our water supplies in an efficient and environmentally sustainable manner. We plan to develop our water and wastewater systems in stages to efficiently meet demands in our service areas, thereby reducing the amount of up-front capital costs required for construction of facilities. We use third-party contractors to construct our facilities as needed. We employ licensed water and wastewater operators to operate our water and wastewater systems. As our systems expand, we expect to hire additional personnel to operate our systems, which include water production, treatment, testing, storage, distribution, metering, billing, and operations management.

Our water and wastewater systems conjunctively use surface and groundwater supplies and storage of raw water and highly treated effluent supplies to provide a balanced sustainable water supply for our wholesale customers and their end-use customers. Integrating conservation practices and incentives together with effective water reuse demonstrates our commitment to providing environmentally responsible, sustainable water and wastewater services. Water supplies and water storage reservoirs are competitively sought throughout the west and along the Front Range of Colorado. We believe regional cooperation among area water providers in developing new water supplies, water storage, and transmission and distribution systems provides the most cost effective way of expanding and enhancing service capacities for area water providers. We continue to discuss developing water supplies and water storage opportunities with area water providers.

We expect the development of our Rangeview Water Supply to require a significant number of high capacity deep water wells. We anticipate drilling separate wells into each of the three principal aquifers located beneath the Lowry Range. Each well is intended to deliver water to central water treatment facilities for treatment prior to delivery to customers. Development of our Lowry Range surface water supplies will require facilities to divert surface water to storage reservoirs to be located on the Lowry Range and treatment facilities to treat the water prior to introduction into our distribution systems. Surface water diversion facilities will be designed with capacities to divert the surface water when available (particularly during seasonal events such as spring run-off and summer storms) for storage in reservoirs to be constructed on the Lowry Range. Based on preliminary engineering estimates, the full build-out of water facilities (including diversion structures, transmission pipelines, reservoirs, and water treatment facilities) on the Lowry Range will cost in excess of \$340 million, based on estimated costs, and will accommodate water service to customers located on and outside the Lowry Range. We expect this build out to occur in phases over an extended period of time, and we expect that tap fees will be sufficient to fund the infrastructure costs.

Our Denver-based supplies are a valuable, locally available resource located near the point of use. This enables us to incrementally develop infrastructure to produce, treat and deliver water to customers based on their growing demands.

During fiscal 2016, we, along with the District, invested approximately \$368,600 to construct an effluent storage pond on the Lowry Range. We anticipate during fiscal 2017 that we will invest between \$4.5 million to \$5 million to construct pipelines that will interconnect the Rangeview, WISE, and Sky Ranch water systems. We also anticipate investing in pipelines at the Sky Ranch property in anticipation of the development of the first phase of the property. We also expect to add additional wells as demand grows.

The District is a participant in the WISE project. This project is developing infrastructure to interconnect providers' water systems and to extend renewable water sources owned by Denver Water and Aurora Water to participating South Metro water providers, including the District and, through our agreements with the District, us. This system will diversify our sources of water and will enable providers to move water among themselves, which will increase the reliability of our and others' water systems. Through the WISE Financing Agreement, we funded the District's purchase of certain rights to use existing water transmission and related infrastructure acquired and constructed by



the WISE project. We invested approximately \$113,600 in the WISE system during fiscal 2016 and have invested approximately \$2.9 million to date. We anticipate that we will be spending approximately \$650,000 on this system during fiscal 2017 and \$5 million during the next four years to fund the District's purchase of its share of the water transmission line and additional facilities, water and related assets for WISE and to fund operations and water deliveries related to WISE. Timing of the investment will vary depending on the schedule of projects within WISE.

We are in the process of planning development of our Sky Ranch property, including evaluating possible joint venture opportunities pursuant to which we would build the water and wastewater infrastructure for housing and commercial development of the property. We currently anticipate the first phase of development will begin in the second half of calendar 2017, subject to obtaining approvals and the timing of the final design. The timing for us to develop the remaining phases of the property will be largely dependent on the Denver real estate market and the interest we receive from home builders and developers. During fiscal 2016 we invested approximately \$285,600 in our Sky Ranch property, which consisted of development planning, preliminary design, and related filing fees.

We plan to develop additional water assets within the Denver area and are exploring opportunities to utilize our water assets in areas adjacent to our existing water supplies.

#### Water and Growth in Colorado

After experiencing a weak economy through 2012, much like that of the U.S. as a whole, Colorado began recovering during 2013 and 2014 and continued to improve during 2015 and 2016. The key drivers in our business model are:

**Housing Starts** – From September 2015 to September 2016, annual housing starts increased by 24%. From September 2014 to September 2015, annual housing starts increased by 18%.

**Unemployment** – The unemployment rate in Colorado was 3.8% at August 31, 2016, compared to a national unemployment rate of 4.9%. Colorado added an estimated 71,600 jobs from August 2015 to August 2016.

**Population** – The Denver Regional Council of Governments (“DRCOG”), a voluntary association of over 50 county and municipal governments in the Denver metropolitan area, estimates that the Denver metropolitan area population will increase by about 38% from today's 3.4 million people to 4.7 million people by the year 2040. A Statewide Water Supply Initiative report by the Colorado Water Conservation Board estimates that the South Platte River basin, which includes the Denver metropolitan region, will grow from a current population of 3.9 million to 4.9 million by the year 2030, while the state's population will increase from 5.7 million to 7.2 million.

**Demand** – Approximately 70% of the state's projected population increase is anticipated to occur within the South Platte River basin. Significant increases in Colorado's population, particularly in the Denver metro region and other areas in the water-short South Platte River basin, together with increasing agricultural, recreational, and environmental water demands, will intensify competition for water supplies. The estimated population increases are expected to result in demands for water services in excess of the current capabilities of municipal service providers, especially during drought conditions.

**Supply** – The Statewide Water Supply Initiative estimates that population growth in the Denver region and the South Platte River basin could result in additional water supply demands of over 400,000 acre feet by the year 2030.

**Development** – Colorado law requires property developers to demonstrate that they have sufficient water supplies for their proposed projects before rezoning applications will be considered. These factors indicate that water and availability of water will continue to be critical to growth prospects for the region and the state, and that competition for available sources of water will continue to intensify. We focus the marketing of our water supplies and services to

developers and home builders that are active along the Colorado Front Range as well as other area water providers in need of additional supplies.

Colorado's future water supply needs will be met through conservation, reuse and the development of new supplies. The District's rules and regulations for water and wastewater service call for adherence to strict conservation measures, including low-flow water fixtures, high efficiency appliances, and advanced irrigation control devices. Additionally, our systems are designed and constructed using a dual-pipe water distribution system to segregate the delivery of high quality potable drinking water to our local governmental entities and their end-use customers through one system and a second system to supply raw or reclaimed water for irrigation demands. About one-half of



the water used by a typical Denver-area residential water customer is used for outdoor landscape and lawn irrigation. We believe that raw or reclaimed water supplies provide the lowest cost, most environmentally sustainable water for outdoor irrigation. We expect our systems to include an extensive water reclamation system in which essentially all effluent water from wastewater treatment plants will be reused to meet non-potable water demands. Our dual-distribution systems demonstrate our commitment to environmentally responsible water management policies in our water short region.

### Competition

We negotiate individual service agreements with our governmental customers and with their developers and/or home builders to design, construct and operate water and wastewater systems and to provide services to end-use customers of governmental entities and to commercial and industrial customers. These service agreements seek to address all aspects of the development of the water and wastewater systems including:

- (i) the purchase of water and wastewater taps in exchange for our obligation to construct certain Wholesale Facilities;
- (ii) the establishment of payment terms, timing, capacity and location of Special Facilities (if any); and
- (iii) specific terms related to our provision of ongoing water and wastewater services to our local governmental customers as well as the governmental entity's end-use customers.

Although we have exclusive long-term water and wastewater service contracts for 24,000 acres of the 27,000-acre Lowry Range pursuant to the Service Agreement, providing water and wastewater services to areas other than Sky Ranch and the majority of the Lowry Range is subject to competition. Alternate sources of water are available, principally from other private parties, such as farmers or others owning water rights that have historically been used for agriculture, and from municipalities seeking to annex new development areas in order to increase their tax base. Our principal competition in areas close to the Lowry Range is the City of Aurora. Principal factors affecting competition for potential purchasers of our Export Water include the availability of water for the particular purpose, the cost of delivering the water to the desired location (including the cost of required taps), and the reliability of the water supply during drought periods. We estimate that the water assets we own and have the exclusive right to use have a supply capacity of approximately 57,800 SFE units, and we believe they provide us with a significant competitive advantage along the Front Range. Our legal rights to the Rangeview Water Supply have been confirmed for municipal use, and our water supply is close to Denver area water users. We believe our pricing structure is competitive and our water portfolio is well balanced with senior surface water rights, groundwater rights, storage capacity and reclaimed water supplies.

### Environmental, Health and Safety Regulation

Provision of water and wastewater services is subject to regulation under the federal Safe Drinking Water Act, the Clean Water Act, related state laws, and federal and state regulations issued under these laws. These laws and regulations establish criteria and standards for drinking water and for wastewater discharges. In addition, we are subject to federal and state laws and other regulations relating to solid waste disposal and certain other aspects of our operations.

Environmental compliance issues may arise in the normal course of operations or as a result of regulatory changes. We attempt to align capital budgeting and expenditures to address these issues in a timely manner.

**Safe Drinking Water Act** – The Safe Drinking Water Act establishes criteria and procedures for the U.S. Environmental Protection Agency (the “EPA”) to develop national quality standards for drinking water. Regulations issued pursuant to the Safe Drinking Water Act and its amendments set standards on the amount of certain microbial and chemical

contaminants and radionuclides allowable in drinking water. The State of Colorado has assumed primary responsibility for enforcing the standards established by the Safe Drinking Water Act and has adopted the Colorado Primary Drinking Water Standards (5 CCR 1003-1). Current requirements for drinking water are not expected to have a material impact on our financial condition or results of operations as we have made and are making investments to meet existing water quality standards. In the future, we might be required to change our



method of treating drinking water and make additional capital investments if additional regulations become effective.

The federal Groundwater Rule became effective December 1, 2009. This rule requires additional testing of water from well sources and under certain circumstances requires demonstration and maintenance of effective disinfection. In 2009, Colorado adopted Article 13 to the Colorado Primary Drinking Water Standards to establish monitoring and compliance criteria for the Groundwater Rule. We have implemented measures to comply with the Groundwater Rule.

**Clean Water Act** – The Clean Water Act regulates wastewater discharges from drinking water and wastewater treatment facilities and storm water discharges into lakes, rivers, streams, and wetlands. The State of Colorado has assumed primary responsibility for enforcing the standards established by the federal Clean Water Act for wastewater discharges from domestic water and wastewater treatment facilities and has adopted the Colorado Water Quality Control Act and related regulations, which also regulate discharges to groundwater. It is our policy to obtain and maintain all required permits and approvals for discharges from our water and wastewater facilities and to comply with all conditions of those permits and other regulatory requirements. A program is in place to monitor facilities for compliance with permitting, monitoring and reporting for wastewater discharges. From time to time, discharge violations might occur which might result in fines and penalties, but we have no reason to believe that any such fines or penalties are pending or will be assessed.

In the future, we anticipate changing our method of treating wastewater, which will require future additional capital investments, as additional regulations become effective. During fiscal year 2016, we invested \$368,600 to design, permit and construct a 13 million gallon effluent storage reservoir at our wastewater treatment facility and have converted our facility to a zero discharge treatment facility. We are storing the treated effluent water and expect to use the water for agricultural and irrigation uses.

**Solid Waste Disposal** – The handling and disposal of residuals and solid waste generated from water and wastewater treatment facilities is governed by federal and state laws and regulations. We have a program in place to monitor our facilities for compliance with regulatory requirements, and we do not anticipate that costs associated with our handling and disposal of waste material from our water and wastewater operations will have a material impact on our business or financial condition.

#### Employees

We currently have six full-time employees.

#### Available Information and Website Address

Our website address is [www.purecyclewater.com](http://www.purecyclewater.com). We make available free of charge through our website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to these reports as soon as reasonably practicable after filing with the Securities and Exchange Commission (“SEC”).

These reports and all other material we file with the SEC may be obtained directly from the SEC’s website, [www.sec.gov/edgar/searchedgar/companysearch.html](http://www.sec.gov/edgar/searchedgar/companysearch.html), under CIK code 276720. The contents of our website are not incorporated by reference into this report. You may also read and copy any materials we file with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, DC 20549. Operating information for the Public Reference Room is available by calling the SEC at 1-800-SEC-0330.

#### Item 1A – Risk Factors

The following section describes the material risks and uncertainties that management believes could have a material adverse effect on our business, financial condition, results of operations, and the market price of our common stock. The risks discussed below include forward-looking statements, and our actual results may differ materially from those discussed in these forward-looking statements. These risks should be read in conjunction with the other information set forth in this report, including the accompanying financial statements and notes thereto.

Our net losses may continue and we may not have sufficient cash flows from operations or other capital resources to pursue our business objectives. We have experienced significant net losses, our cash flows from



operations have not been sufficient to fund our operations in the past and we have been required to raise debt and equity capital and sell assets to remain in operation. Since 2004, we have obtained \$76.2 million through (i) the issuance of \$25.2 million of common stock (includes the issuance of stock pursuant to the exercise of options, net of expenses), (ii) the issuance of \$5.2 million of Convertible Debt, which was converted to common stock on January 11, 2011, and (iii) the sale of our Arkansas River water and land for approximately \$45.8 million in cash. Our ability to fund our operational needs and meet our business objectives will depend on our ability to generate cash from future operations. We currently have a limited number of customers. If our future cash flows from operations and other capital resources are not sufficient to fund our operations and the significant capital expenditure requirements to build our water delivery systems, we may be forced to reduce or delay our business activities, or seek to obtain additional debt or equity capital. Economic conditions and disruptions have previously caused substantial volatility in capital markets, including credit markets and the banking industry, increasing the cost and significantly reducing the availability of financing, which may reoccur in the future. There can be no assurance that financing will be available on acceptable terms or at all.

The rates the District is allowed to charge customers on the Lowry Range are limited by the Lease with the Land Board, and our contract with the District and may not be sufficient to cover our costs of construction and operation. The prices charged by the District for water service on the Lowry Range are subject to pricing regulations set forth in the Lease with the Land Board. Both the tap fees and usage rates and charges are capped at the average of the rates of three nearby water providers. Annually the District surveys the tap fees and rates of the three nearby providers, and the District may adjust tap fees and rates and charges for water service on the Lowry Range based on the average of those charged by this group, and we receive 98% of whatever the District charges its customers. Our costs associated with the construction of water delivery systems and the production, treatment and delivery of water are subject to market conditions and other factors, which may increase at a significantly higher rate than that of the fees we receive from the District. Factors beyond our control and which cannot be predicted, such as government regulations, insurance and labor markets, drought, water contamination and severe weather conditions, like tornadoes and floods, may result in additional labor and material costs that may not be recoverable under the current rate structure. Either increased customer demand or increased water conservation may also impact the overall cost of our operations. If the costs for construction and operation of our wholesale water services, including the cost of extracting our groundwater, exceed our revenues, we would be providing service to the District for use at the Lowry Range at a loss. The District may petition the Land Board for rate increases; however, there can be no assurance that the Land Board would approve a rate increase request. Further, even if a rate increase were approved, it might not be granted in a timely manner or in an amount sufficient to cover the expenses for which the rate increase was sought.

Our business is subject to seasonal fluctuations and weather conditions that could affect demand for our water service and our revenues. We depend on an adequate water supply to meet the present and future demands of our customers and their end-use customers and to continue our expansion efforts. Conditions beyond our control may interfere with our water supply sources. Drought and overuse may limit the availability of water. These factors might adversely affect our ability to supply water in sufficient quantities to our customers, and our revenues and earnings may be adversely affected. Additionally, cool and wet weather, as well as drought restrictions and our customers' conservation efforts, may reduce consumption demands, adversely affecting our revenue and earnings. Furthermore, freezing weather may contribute to water transmission interruptions caused by pipe and main breakage. If we experience an interruption in our water supply, it could have a material adverse effect on our financial condition and results of operations. Demand for our water during the warmer months is generally greater than during cooler months due primarily to additional requirements for water in connection with cooling systems, irrigation systems and other outside water use. Throughout the year, and particularly during typically warmer months, demand will vary with temperature and rainfall levels. If temperatures during the typically warmer months are cooler than expected or there is more rainfall than expected, the demand for our water may decrease and adversely affect our revenues.

Sales to the fracking industry can fluctuate significantly. Our water sales have been historically highly concentrated directly and indirectly with one company providing fracking services to the oil and gas industry on and around the

Lowry Range and our Sky Ranch property. Sales to this customer base as well as renewals of our oil and gas leases, if any, in the future are impacted by regulations, fracking technologies, the success of the wells and the price of oil and gas, among other things. Investment in oil and gas development is dependent on the price of oil and gas and, recently, the price of oil has decreased significantly and has remained at relatively low levels. These water



sales essentially ceased in March 2015, and we have no contractual commitment that will ensure these sales will resume in the future.

We are dependent on the housing market and development in our targeted service areas for future revenues. Providing wholesale water service using our Colorado Front Range water supplies is our principal source of future revenue. The timing and amount of these revenues will depend significantly on housing developments being built near our water assets. The development of these areas is subject to many factors that are not within our control, and there can be no assurance that development will occur or that water sales will occur on acceptable terms or in the amounts or time required for us to support our costs of operation. In the event wholesale water sales are not forthcoming or development on the Lowry Range, Sky Ranch or other developments in our targeted service areas is delayed indefinitely, we may need to use our capital resources, incur additional short or long-term debt obligations or seek to sell additional equity, and there are no assurances that we would have sufficient capital resources or be successful in obtaining additional operating capital. After several years of significant declines in new home construction, there have been positive market gains in the Colorado housing market since 2013. However, if the downturn in the homebuilding and credit markets return or if the national economy weakens and economic concerns intensify, it could have a significant negative impact on our business and financial condition.

Development on the Lowry Range is not within our control and is subject to obstacles. Development on the Lowry Range is controlled by the Land Board, which is governed by a five-person citizen board of commissioners representing education, agriculture, local government and natural resources, plus one at-large commissioner, each appointed for a four-year term by the Colorado governor and approved by the Colorado Senate. The Land Board's focus with respect to issues such as development and conservation on the Lowry Range tends to change as membership on the Land Board changes. In addition, there are often significant delays in the adoption and implementation of plans with respect to property administered by the Land Board because the process involves many constituencies with diverse interests. In the event water sales are not forthcoming or development of the Lowry Range is delayed or abandoned, we may need to use our capital resources, incur additional short or long-term debt obligations or seek to sell additional equity, and there are no assurances that we would have sufficient capital resources or be successful in obtaining additional operating capital.

Because of the prior use of the Lowry Range as a military facility, environmental clean-up may be required prior to development, including the removal of unexploded ordnance. The U.S. Army Corps of Engineers has been conducting unexploded ordnance removal activities at the Lowry Range for more than 20 years. Continued activities are dependent on federal appropriations, and the Army Corps of Engineers has no assurance from year to year of such appropriations for its activities at the Lowry Range.

Our construction of water and wastewater projects may expose us to certain completion, performance and financial risks. We expect to rely on independent contractors to construct our water and wastewater facilities. These construction activities may involve risks, including shortages of materials and labor, work stoppages, labor relations disputes, weather interference, engineering, environmental, permitting or geological problems and unanticipated cost increases. These issues could give rise to delays, cost overruns or performance deficiencies, or otherwise adversely affect the construction or operation of our water and wastewater delivery systems. In addition, we may experience quality problems in the construction of our systems and facilities, including equipment failures. We cannot assure you that we will not face claims from customers or others regarding product quality and installation of equipment placed in service by contractors.

Certain of our contracts may be fixed-price contracts, in which we may bear all or a significant portion of the risk for cost overruns. Under these fixed-price contracts, contract prices are established in part based on fixed, firm subcontractor quotes on contracts and on cost and scheduling estimates. These estimates may be based on a number of assumptions, including assumptions about prices and availability of labor, equipment and materials, and other issues. If these subcontractor quotations or cost estimates prove inaccurate, or if circumstances change, cost overruns may

occur, and our financial results would be negatively impacted. In many cases, the incurrence of these additional costs would not be within our control.

We may have contracts in which we guarantee project completion by a scheduled date. At times, we may guarantee that the project, when completed, will achieve certain performance standards. If we fail to complete the project as scheduled, or if we fail to meet guaranteed performance standards, we may be held responsible for cost impacts



and/or penalties to the customer resulting from any delay or for the costs to alter the project to achieve the performance standards. To the extent that these events occur and are not due to circumstances for which the customer accepts responsibility or cannot be mitigated by performance bonds or the provisions of our agreements with contractors, the total costs of the project would exceed our original estimates and our financial results would be negatively impacted.

Our customers may require us to secure performance and completion bonds for certain contracts and projects. The market environment for surety companies has become more risk averse. We secure performance and completion bonds for our contracts from these surety companies. To the extent we are unable to obtain bonds, we may not be awarded new contracts. We cannot assure you that we can secure performance and completion bonds when required. Design, construction or system failures could result in injury to third parties or damage to property. Any losses that exceed claims against our contractors, the performance bonds and our insurance limits at such facilities could result in claims against us. In addition, if there is a customer dispute regarding performance of our services, the customer may decide to delay or withhold payment to us.

We have a limited number of employees and may not be able to manage the increasing demands of our operations. We have a limited number of employees to administer our existing assets, interface with applicable governmental bodies, market our services and plan for the construction and development of our future assets. We may not be able to maximize the value of our water assets because of our limited manpower. We depend significantly on the services of Mark W. Harding, our President and Chief Financial Officer. The loss of Mr. Harding would cause a significant interruption of our operations. The success of our future business development and ability to capitalize on growth opportunities depends on our ability to attract and retain additional experienced and qualified persons to operate and manage our business. State regulations set the training, experience and qualification standards required for our employees to operate specific water and wastewater facilities. Failure to find state-certified and qualified employees to support the operation of our facilities could put us at risk for, among other things, regulatory penalties (including fines and suspension of operations), operational errors at the facilities, improper billing and collection processes, and loss of contracts and revenues. We cannot assure you that we can successfully manage our assets and our growth.

A failure of the water wells or distribution networks that we own or control could result in losses and damages that may affect our financial condition and reputation. We distribute water through a network of pipelines and store water in storage tanks and a pond. A failure of these pipelines, tanks or the pond could result in injuries and damage to property for which we may be responsible, in whole or in part. The failure of these pipelines, tanks, or pond may also result in the need to shut down some facilities or parts of our water distribution network in order to conduct repairs. Such failures and shutdowns may limit our ability to supply water in sufficient quantities to our customers and to meet the water delivery requirements prescribed by our contracts, which could adversely affect our financial condition, results of operations, cash flow, liquidity and reputation. Any business interruption or other losses might not be covered by insurance policies or be recoverable through rates and charges, and such losses may make it difficult for us to secure insurance in the future at acceptable rates.

Conflicts of interest may arise relating to the operation of the District and the Sky Ranch District. Our officers and employees constitute 60% of the directors of the District as well as the Sky Ranch District. Pure Cycle, along with our officers and employees and two unrelated individuals, own the 40 acres that constitute the District and the acreage that constitutes the Sky Ranch Metropolitan District that will be the retail water and wastewater service provider for the first phase of Sky Ranch. We have made loans to the District to fund its operations. At August 31, 2016, total principal and interest owed to us by the District was \$628,500. Pursuant to our Service Agreement with the District for the provision of water services, the District retains two percent of the revenues from the sale of water to its end-use customers on the Lowry Range. Proceeds from the fee collections will initially be used to repay the District's obligations to us, but after these loans are repaid, the District is not required to use the funds to benefit Pure Cycle. Similarly, we have made loans to and incurred expenses reimbursable by the Sky Ranch District. At August 31, 2016, total principal and interest owed to us by the Sky Ranch District was \$171,900. It is anticipated that these amounts will be repaid once Sky Ranch has sold residential units and has customers to pay for services. We have received benefits from our activities undertaken in conjunction with these districts, but conflicts may arise between our interests and those of the districts and our officers and employees who are acting in dual capacities in negotiating contracts to which both we and a district are parties. We expect that both districts will expand when more properties

are developed and become part of the respective districts, and our officers and employees acting as directors of these districts will have fiduciary

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obligations to those other constituents. There can be no assurance that all conflicts will be resolved in the best interests of the Company and our shareholders. In addition, other landowners coming into a district will be eligible to vote and to serve as directors of that district. There can be no assurances that our officers and employees will remain as directors of either District or that the actions of subsequently elected boards would not have an adverse impact on our operations.

Our operations are affected by local politics and governmental procedures which are beyond our control. We operate in a highly political environment. We market our water rights to municipalities and other governmental entities run by elected or politically appointed officials. Our principal competitors are municipalities seeking to expand their sales tax base and other water districts. Various constituencies, including our competitors, developers, environmental groups, conservation groups, and agricultural interests, have competing agendas with respect to the development of water rights in Colorado, which means that decisions affecting our business are based on many factors other than economic and business considerations. Additional risks associated with dealing with governmental entities include turnover of elected and appointed officials, changes in policies from election to election, and a lack of institutional history in these entities concerning their prior courses of dealing with the Company. We spend significant time and resources educating elected officials, local authorities and others regarding our water rights and the benefits of contracting with us. Political concerns and governmental procedures and policies may hinder or delay our ability to enter into service agreements or develop our water rights or infrastructure to deliver our water. While we have worked to reduce the political risks in our business through our participation as the service provider for the District in regional cooperative resource programs, such as the SMWSA and its WISE partnership with Denver Water and Aurora Water, as well as education and communication efforts and community involvement, there can be no assurance that our efforts will be successful.

Our Lowry Range Surface water rights are “conditional decrees” and require findings of reasonable diligence. Our surface water interests and reservoir sites at the Lowry Range are conditionally decreed and are subject to a finding of reasonable diligence from the Colorado water court every six years. To arrive at a finding of reasonable diligence, the water court must determine that we continue to diligently pursue the development of said water rights. If the water court is unable to make such a finding, we could lose the water right under review. During fiscal 2012, the Lowry Range conditional decrees were granted their first review by the water court which determined that we and the District met the diligence criteria. The water court entered a finding of reasonable diligence on the Lowry Range surface water decrees on February 11, 2012. Our next diligence period will be in February 2018. If the water court does not make a determination of reasonable diligence in 2018, it would materially adversely impact the value of our interests in the Rangeview surface water supply.

Water quality standards are subject to regulatory change. We must provide water that meets all federal and state regulatory water quality standards and operate our water and wastewater facilities in accordance with these standards. Future changes in regulations governing the supply of drinking water and treatment of wastewater may have a material adverse impact on our financial results. With respect to service of customers on the Lowry Range, the District’s rates might not be sufficient to cover the cost of compliance with additional or more stringent requirements. If the cost of compliance were to increase, we anticipate that the rates of the nearby water providers that the District uses to establish its rates and charges would increase to reflect these cost increases, thereby allowing the District to increase its rates and charges. However, there can be no assurance that these water providers would raise their rates in an amount that would be sufficient to enable the District (and us) to cover any increased compliance costs.

Contamination to our water supply may result in disruption in our services and litigation, which could adversely affect our business, operating results and financial condition. Our water supplies are subject to the risk of potential contamination, including contamination from naturally occurring compounds, pollution from man-made sources and intentional sabotage. Our land at Sky Ranch and a portion of the Lowry Range have been leased for oil and gas exploration and development. Such exploration and development could expose us to additional contamination risks from related leaks or spills. In addition, we handle certain hazardous materials at our water treatment facilities, primarily sodium hypochlorite. Any failure of our operation of the facilities or any contamination of our supplies,

including sewage spills, noncompliance with water quality standards, hazardous materials leaks and spills, and similar events could expose us to environmental liabilities, claims and litigation costs. If any of these events occur, we may have to interrupt the use of that water supply until we are able to substitute the



supply from another source or treat the contaminated supply. We cannot assure you that we will successfully manage these issues, and failure to do so could have a material adverse effect on our future results of operations.

We may incur significant costs in order to treat the contaminated source through expansion of our current treatment facilities or development of new treatment methods. If we are unable to substitute water supply from an uncontaminated water source, or to adequately treat the contaminated water source in a cost-effective manner, there may be an adverse effect on our revenues, operating results and financial condition. The costs we incur to decontaminate a water source or an underground water system could be significant and could adversely affect our business, operating results and financial condition and may not be recoverable in rates.

We could also be held liable for consequences arising out of human exposure to hazardous substances in our water supplies or other environmental damage. For example, private plaintiffs could assert personal injury or other toxic tort claims arising from the presence of hazardous substances in our drinking water supplies. Although we have not been a party to any environmental or pollution-related lawsuits, such lawsuits have increased in frequency in recent years. If we are subject to an environmental or pollution-related lawsuit, we might incur significant legal costs, and it is uncertain whether we would be able to recover the legal costs from ratepayers or other third parties. Our insurance policies may not cover or provide sufficient coverage for the costs of these claims.

Climate change laws and regulations may be adopted by federal and state environmental agencies that could require additional capital expenditures and increase our operating costs. Climate change is receiving ever increasing attention worldwide. Possible new climate change laws and regulations, if enacted, may require us to monitor and/or change our operations. It is possible that new standards could be imposed that will require additional capital expenditures or raise our operating costs. With respect to service of customers on the Lowry Range, the District's rates might not be sufficient to cover the cost of compliance with new requirements. Although we would expect the rates of the nearby water providers that the District uses to establish its rates and charges to increase to cover increased compliance costs, we cannot assure you that our costs of complying with new standards or laws will not adversely affect our business, results of operations or financial condition.

We may be adversely affected by any future decision by the Colorado Public Utilities Commission to regulate us as a public utility. The Colorado Public Utilities Commission ("CPUC") regulates investor-owned water companies operating for the purpose of supplying water to the public. The CPUC regulates many aspects of public utilities' operations, including establishing water rates and fees, initiating inspections, enforcement and compliance activities and assisting consumers with complaints. We do not believe we are a public utility under Colorado law. We currently provide services by contract mainly to the District, which supplies the public. Quasi-municipal metropolitan districts, such as the District and the Sky Ranch District, are exempt by statute from regulation by the CPUC. However, the CPUC could attempt to regulate us as a public utility. If this were to occur, we might incur significant expense challenging the CPUC's assertion of jurisdiction, and we may be unsuccessful. In the future, existing regulations may be revised or reinterpreted, and new laws and regulations may be adopted or become applicable to us or our facilities. If we become regulated as a public utility, our ability to generate profits could be limited, and we might incur significant costs associated with regulatory compliance.

The District's and our rights under the Lease have been challenged by third parties. The District's and our rights under the Lease have been challenged by third parties, including the Land Board, in the past. In 2014, in connection with settling a lawsuit filed by us and the District against the Land Board, the Land Board, the District and we amended and restated the Lease to clarify and update a number of provisions. However, there are issues still subject to negotiation and it is likely that during the remaining 65-year term of the Lease the parties will disagree over interpretations of provisions in the Lease again. There can be no assurance that the District's or our rights under the Lease will not be challenged in the future, which could require potentially expensive litigation to enforce our rights.

We are subject to the risk of possibly being required to register as an investment company. On August 18, 2015, we completed the sale of our Arkansas River properties and water rights for approximately \$45.8 million in cash. The net proceeds still remaining from that sale, which currently represents 42% of our total assets, are currently invested in U.S. treasury notes and certificates of deposit, which may be regarded as “investment securities” under the Investment Company Act of 1940, as amended (the “Investment Company Act”). Although our board of directors believes that we are not engaged primarily in the business of investing, reinvesting, or trading in securities, and we do not hold ourselves out as being primarily engaged in those activities, we could fall within the scope of



Section 3(a)(1)(C) of the Investment Company Act if the net proceeds from the sale of the Arkansas River water properties and water rights and other cash and cash equivalents are invested in investment securities (as defined in the Investment Company Act) and such investment securities represent more than 40% of our total assets (exclusive of cash and certain cash equivalents). A company that falls within the scope of Section 3(a)(1)(C) of the Investment Company Act can avoid being regulated as an investment company if it can rely on certain of the exclusions from being deemed to be an “investment company” under the Investment Company Act. One such exclusion is Rule 3a-2 under the Investment Company Act, which provides that a company is deemed not to be an investment company during a period of time not to exceed one year provided that the company has a bona fide intent to be engaged primarily, as soon as is reasonably possible (in any event by the termination of such period of time), in a business other than that of an investment company. If necessary, our board of directors would explore transactions pursuant to which we would cease to be deemed to be an investment company, such as the disposition of our investment securities, including through liquidation, or the acquisition of sufficient assets that are not investment securities in order for us not to be deemed an investment company under the Investment Company Act. There can be no assurance that we would be able to complete such actions by the applicable deadline, or at all. If we were required to register as an “investment company” under the Investment Company Act, applicable restrictions could make it impractical for us to continue our business as currently conducted and could have a material adverse effect on us.

Our stock price has been volatile in the past and may decline in the future. Our common stock has experienced significant price and volume fluctuations in the past and may experience significant fluctuations in the future depending upon a number of factors, some of which are beyond our control. Factors that could affect our stock price and trading volume include, among others, the perceived prospects of our business; differences between anticipated and actual operating results; changes in analysts’ recommendations or projections; the commencement and/or results of litigation and other legal proceedings; and future sales of our common stock by us or by significant shareholders, officers and directors. In addition, stock markets in general have experienced price and volume volatility from time to time, which may adversely affect the market price of our common stock for reasons unrelated to our performance.

#### Item 1B – Unresolved Staff Comments

None.

#### Item 2 – Properties

Corporate Office – Effective January 2016, we entered into an operating lease for approximately 2,500 square feet of office and warehouse space. The lease has a one-year term with payments of \$3,000 per month. We plan to extend our lease for office space after December 2016.

Water Related Assets – In addition to the water rights and adjudicated reservoir sites that are described in Item 1 – Our Water and Land Assets, we also own a 500,000-gallon water tank, 400,000-barrel storage reservoir, a 300,000-barrel storage reservoir, three deep water wells, a pump station, and several miles of water pipeline in Arapahoe County, Colorado. Additionally, although owned by the District, we operate and maintain another 500,000-gallon water tank, two deep water wells, a pump station, three alluvial wells, the District’s wastewater treatment plant, and water distribution and wastewater collection pipelines that serve customers located at the Lowry Range. These assets are used to provide service to our existing customers.

Land – We own approximately 931 acres of land known as Sky Ranch that is described further in Item 1 – Our Water and Land Assets – Sky Ranch. We also own 40 acres of land that comprise the current boundaries of the District.

#### Item 3 – Legal Proceedings

None.

Item 4 – Mine Safety Disclosures

None.

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## PART II

## Item 5 – Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

## Market Information

Our common stock is traded on the NASDAQ Capital Market under the symbol “PCYO.” The high and low sales prices of our common stock, by quarter, for the fiscal years ended August 31, 2016 and 2015 are presented below:

Table E - Market Information

Fiscal 2016 quarters ended:	August 31	May 31	February 29	November 30
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## Market price of common stock

High	\$5.20	\$4.91	\$5.12	\$5.73
Low	\$4.34	\$4.29	\$3.65	\$4.56

Fiscal 2015 quarters ended:	August 31	May 31	February 28	November 30
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## Market price of common stock

High	\$5.55	\$5.50	\$5.26	\$7.00
Low	\$4.37	\$4.12		