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Transcript of
Pure Cycle Corporation
Fiscal Year and Fourth Quarter Ended 2019 Financial Results
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Presentation

Operator
Good day, ladies and gentlemen, and welcome to the Pure Cycle Corporation Fiscal Year and Fourth Quarter Ended 2019 Fiscal Result Call. All lines have been placed in a listen-only mode, and the floor will be opened for questions and comments following the presentation. [Operator instructions].

At this time, it is my pleasure to turn the floor over to your host, Mark Harding, President, CFO, and Director. Sir, the floor is yours.

Mark Harding – President, Chief Financial Officer, and Director
Thank you. I'd like to welcome you all to our Fiscal Year-End 2019 Earnings call. Some housekeeping matters. We do have a slide deck for this presentation. So, if you log on to our website at purecyclewater.com, if you go into the Investor tab and then you'll see there a slide deck that will show you the fiscal year-end slides and then you can follow along and track with me as I work through the presentation. So I'll try and note the transition of the slides as we progress through the presentation.

So, with that, we'll start with our first slide, which actually our second slide, which is our Safe Harbor statement, which is a forward-looking statement that references the discussions in this presentation, which will include some forward-looking forecasts and also some reports of our filings that we had just recently today. So, I think most of you are familiar with the Safe Harbor statement.

What I'd like to do is just for a quick overview for those new to the company or listening in for the first time, give you kind of a brief overview of the company, what it is that we do, kind of where we get some of the revenue from our assets, and then drill down specific on some of the year-end activity and maybe look forward as to what we're going to hope to get accomplish in 2020.

We generate revenue really from two business segments, and while they have two different distinct segments at a DNA level, we're a water utility that owns a substantial portfolio of water-in at water-short region. In addition to what we do on the utility side, we also developed land in a mixed use master planned community, what we really identify as one of the most attractive submarkets in the Denver metropolitan area.

It's a long primary interstate. We have two interstates bisect the city, one east-west, which is the I-70 corridor, which is where we front a portion of our property, and then also we deliver a significant amount of water to the oil and gas industry. Then, finally we generate some revenue from some mineral interests that we own through some oil and gas royalties from oil and gas leaks.

So, we have about 27,000 acre feet of water. That portfolio we use in almost everything that we do, whether that's that we provide domestic or irrigation water to our customers or we use that water supply for industrial water sales.

If you move to slide 4, kind of an overview of the water utility. We look at this as a cradle to grave where we own the water as a resource itself. We produce that water through wells and diversion structures, we treat it, we store it, we distribute it to our customers, and our customers will use that water supply. They pay us for that on a metered water that we deliver to each individual home or business. We collect that wastewater back. They pay us to collect that wastewater back.

We treat that wastewater through our water reclamation facilities, and then we reuse that water for outdoor irrigation purposes. So, we are really a use and reuse system. We credit those return flows that don't come directly back to us through an irrigation return flow system, but look to be able to use and reuse our systems through advanced water treatment processes.

If you move to slide 5, slide 5 will give you kind of an overview of the water utility assets, the amount of water. We have about 27,000 acre feet of water. We have a number of surface wells and deeper aquifer wells. We have storage, both raw water storage and treated water storage. We have a number of miles of distribution lines, two water reclamation facilities, pump stations, and everything that accompanies what would you normally find in a water utility.

Our assets span sort of the reach of the entire Arapahoe County area, so the width of Arapahoe County being more than 20 miles, and then really have exclusive franchise service areas to about 24,000 acres of service area of state-owned property called the Lowry Range as well as what we're working on with the property that we own and we're developing at Sky Ranch.

How we generate revenue. If you move to slide 6, we generate revenue on the utility side through two sources. One is a onetime connection fee, so we get paid to connect to our water and our wastewater systems. Our water connection fees are about $26,600 and our sewer connection fees are about $4,600. So, they combine to be about $31,000 per connection that we add. Whether that connection is a residential connection or a business connection, we all equate that out to what would be the standard amount of water for a single family home.

Then, we get the recurrent revenue. So, this is sort of that annual annuity that we get from delivering water and wastewater service. We get about $1,000 per year per water connection and about $500 per year per sewer connection, and if you look at the capacity that we have, we estimate that we can serve about 60,000 connections with our water portfolio. So, that gives you kind of a top line capacity both in terms of the connection charges as well as the annual usage charges.

If you move to slide 7, slide 8, I'm sorry, what I want to do is kind of overview Sky Ranch, our land development segment. Sky Ranch is a property that we own. We own about 930 acres right along the interstate. It has about a half a mile of frontage along the interstate. It's located about 16 miles east of Downtown Denver, about 4 miles directly south of the Denver International Airport. Our zoning is for about 3,400 residential units and about 2.3 million square feet of commercial retail light industrial space along the interstate.

In our world, we try and translate that into how many connections that will allow us to serve. So, we look at that property alone as being about 5,000 connections where the water service connections, and then you can correlate that also to the number of lots that you do. We'll likely see residential lots in that 3,400 connections' worth, and then a commercial square feet in terms of the land absorption you can kind of use that other 1,600 lots for commercial. They may not go in that area. We may look at that a little bit differently in terms of price per square foot as we develop that commercial outlet. It's a good way to translate how that land development would like to monetize for us.

The next slide kind of defines where we're at in the Denver submarket. We find ourselves in one of the more attractive areas in land development. It's near major metropolitan employment centers. We have terrific transportation access that can provide families, one of the most affordable communities in the Denver metro area, so our target market really is a entry level buyer where they can come in, families can build or buy homes that are anywhere ranging from 1,800 square feet, maybe up to 3,500 square feet with a tri-level walkout basement on some of our lots that back up to some of our open space areas, and prices in the Denver metro area for entry level product are about $350,000. So, this is one of the most affordable master planned communities in the region.

Moving to the next slide. What I wanted to do is include some information about the Denver area's master planned communities, and we subscribed to a real estate tracking service called Metrostudy, and they come out with the quarterly updates and they just recently came out with a quarterly update in the last two weeks. There were some statistics in here I wanted to share with you all because it does relate to what's happening in the Denver market in master planned communities. What they did is they reported on the statistics for the top 60 master planned communities in the Greater Denver MSA, the metropolitan study area.

The interesting statistics are the maturity of most of these master planned communities. What they're seeing is the majority of these master planned communities are nearly built out, and so what they find is that there's a real lack of new master planned communities starting, and that's a stunning statistic here. You can kind of see all of the top 60 of them, and really the top 30 are more than 90% built out. If you get to the next 30, those are going to average out to be maybe 70% built out.

So what that means is it's been slow start for these new master planned communities. That other graphic there will kind of give you an indication, and this is really those master planned communities in our submarket. So, if you look at that graphic in there that's really towards the right hand side of the page, we start to look at Traditions and Tollgate Crossing and Tallyn's Reach, all of those are kind of neighboring master planned communities right next to that bubble area that light red bubble area, which is going to be our Sky Ranch location.

These are master plans that are actually closing out as of this year. So, the overall market and our particular submarket seems to be very timely in our bringing this product online at this time. So, I did want to share that with you because I found that to be a stunning statistic that was just recently released.

Let me detail a little bit more about our land development segment and really how it highlights what we also do in the water utility side and the value that we add not only to the land, but also in the water segment. As we look at land in the metropolitan area, one of the statistics and one of the dilemmas that you have to face right up front is anytime you want to go for zoning in the Denver area, you really have to demonstrate water availability, and that becomes an increasingly difficult thing to do not only for existing annexed areas that may have some legacy annexations far before there were a relationships that tie land use and water availability, but what you look at is the value water creates for a new property and any land entitlements.

So, our ability to develop land concurrently with water utilities allows us to manage inventories on both, where we can manage the inventories on how much capacity we build in our water utility, whether that's in our wastewater system or our water delivery system, and then how much capacity we have in available lots, and those two investments, because they're such big, large scale investments as you bring a community online, the ability to control both of those on a concurrent basis gives you a very nice advantage. It allows you to optimize delivery of both of those on a real-time basis as you can.

In taking a look at the 5,000 connections at Sky Ranch, our water utility where we take the $30,000 per connection represents about $130 million in the water tap fee revenue, $124 million of wastewater tap fee, so it's combined about $155 million in water and wastewater revenue. Then, serving those 5,000 connections, that generates about $7.5 million year-over-year revenue from that $1,500 per connection per year.

This is just what we control. We're vertically integrated in this, so we own the land, we own the water utility and delivery of that water to those customers. So, that's a very significant component for us to be able to continue to deliver that and deliver that in time for the market and in demand for the market, where we're not waiting on a third-party developer to deliver that land, and the developer is not waiting for the utility to deliver capacity in the utilities. A very synergistic relationship.

Let's move on to slide 11 and talk a little bit about kind of the delivery of the first phase rollout. What we have, I guess I classify this as we've done very well on our first opening, better than forecasted, probably ahead of all three of our builders' projections, and so we're very pleased with our results in this thing, not only on our team's delivery of the lots, and what we're doing in managing the project in house, but also our contractors and subcontractors that have worked very hard to make sure that we're delivering all aspects of the utility side to this as well as the land development side.

As of today, we've delivered approximately 277 finished lots, and that's fully finished lots. That's lots have everything attributable to this. So, we've been paid for the full finished lots, and then another 95 platted lots and wet utility lots.

We have two types of contracts with our builders. We have one contract where one of our builders just pays us for the finished lot, the full finished lot ready to build, ready to get a building permit for. Then our two other builders pay us on a progress payment basis, and so that 95 lots is with one of the builders that pays us and we've gotten two milestone deliveries of that.

As of fiscal year-end, we really did deliver the 255, but this is kind of what we've done since that fiscal year-end. So, we've got a tremendous amount of activity going on in the land segment and finishing out this calendar year.

In addition to the deliveries, we have 136 building permits, which means we have 136 water and wastewater taps. The builders must pay their water and wastewater tap at the time of building application. So, we're seeing a nice absorption in our tap fee connection revenues, and really just because of the number of sales, we probably have a dozen homes completely finished and occupied. So, we have residents out there and nearly 80 plus homes under construction.

So, the absorption on this needs to be about seven or eight homes a month, a little bit more or less depending on the builders, and so with that kind of absorption, really all three of our builders have asked us to roll forward our lot deliveries as quickly as we can. So, some of the lots that may have had a contractual takedown in maybe as far out as 2022, are being rolled forward and we should complete all of our lots by end of fiscal year 2020. So, we're going to roll the remaining, if you look at our year-end report, we have 255 finished lots. We'll roll forward the other 251 finished lots by the end of August 2020.

If you move to the next slide, there's some aerial shots of what's occurring in the area. It gives you a little bit of a metric. Home sales is a very fluid number. As of year-end, we were reporting approximately 60 homes sold. I think that number is up close to 100 now, and we're averaging 6, probably closer to 8 homes per builder per month. This kind of defines the lot sales. So, we get paid for our builder contracts from our home builder customers, and that's about on average 70,000, depending on the size of the lot and the location of the lots.

Then, in addition to what we collect from the home builders, we have public improvement reimbursables. What that entails is we are constructing public improvements which include drainage ways, roads, curbs and gutters, and those are developed by us. They're turned over to another governmental entity and they qualify for public improvement reimbursables. We have a taxing entity with the municipality that will issue municipal bonds to reimburse us for a portion of those reimbursable.

So, if you take a look at the total revenue that we received from lot sales on this land development segment, that's closer to about $100,000 a lot, and a portion of that being $30,000 of that comes from the public improvements when they issue those municipal bonds.

So, if you take a look at the first phase, we stand to look at about $50 million, that might be a little bit, a little bit light because we might see a little bit more public improvements in this first phase because we were a little bit weighted with some offsite infrastructure. We had a little bit larger drainage infrastructure because this is in the low spot, we started with the low spot being that we wanted that to be where the wastewater reclamation facility's going to be. So, we had a little bit higher investment in that.

So, we'll see maybe a little bit extra revenue attributable to that. We'll get money from our builders as well as a little bit more money, maybe as much as $10 million more up to closer to $60 million in the first phase because of the weighted investment in some of that public infrastructure.

Then, if you equate out that number to all 5,000 units, if we kept the price the same, that would be about a half a billion dollars. I think we do have some pricing leverage. We have a very successful start to this thing. I think the home builders are doing very well, and so in our next phase we'll take a little sharper pencil through that now that we've established the market.

Speaking of the next phase, if you turn to slide 13, I'll talk about that and we're going to take the next phase, which will be additional residential units as well as some commercial. So, it'll be that shaded area there. It's about 480 acres which includes about 155 acres, 160 acres of commercial retail, light industrial. We'll have some multifamily uses in there, some more detached single-family product, and maybe some attached single-family product, really to diversify the product.

Where we might have three homebuilders in this first phase because of the product segmentation and then multiple different types of offerings here, we may have as many five or six builders in the next phase depending on the level of interest. We want to keep that inventory number per builder in that maybe two to three-year range so that they're not inventorying too much, and we're not inventorying and holding aside some of that capacity.

We're looking at kind of maybe 800 or 900 residential units in this area, and then maybe in total all 2.5 million square feet of the commercial space. It'll take a while for some of that commercial space to absorb, but that presents a terrific opportunity because as opposed to selling a lot, we're selling that land by the square foot. So, that's an attractive mechanism for us in that.

In this second phase, we may be seeing as many as somewhere 2,500 to 3,000 single-family equivalent connections. So, that would give you some pairing in terms of how we equate that out in terms of the water tap fees.

Moving on to the next page, slide 14, we'll talk a little bit about some of our oil and gas activities. So, we do provide water for the oil and gas industry for fracking purposes. We have an area of interest here that's known as the Niobrara oil shale formation, so it's a very prolific oil shale, and the rock has tremendous capacity. Operators in this area have spent more than $2 billion exploring, leasing, developing wells and pipelines and a lot infrastructure in this area.

The interesting thing about it is it sits right on top of where our water is. So, for operators looking to obtain water supplies, it's a very cost effective way for us to transfer water from our system to their pad sites. It's a very good relationship because we are long on water. They're a very water active, water intensive use of that.

There's been about 130 wells drilled to date, and I'd say that's probably just the very, very beginning of a field. When you look at over 200 square miles and have 130 wells out there, they're really just getting started on this, and a lot of that money that's been spent has been spent on gas and oil collection systems. So, they've put that investment in there with the confidence that it's a very oil rich play and that they're very confident of the yield of this field.

Getting a little bit ahead, but on the next slide, I'll talk a little bit more about sort of pad spacing and this being a stack play. When we're supplying water for these fracks, they're using a tremendous amount of water. So, the current designs for their fracks are usually about 15 million gallons of water for every frack or every well that they do, and that generates about $200,000 to the company per well. So, we're really excited to have that opportunity and really look to extend that service to multiple operators. We probably have as many as four different operators in this field now, and we expect to see water sales in this area continue for the foreseeable future. This could be decade's worth of opportunity for us as they continue to drill in this field.

Let's move on to some of the number crunching. For those of you that are following the company for a number of years, I'd say 2019, candidly is going to be a tipping point for Pure Cycle. We increased our revenues almost 350%, so moving from about $7 million to a little more than $20 million and then increased our income almost 1000%. So, we're moving from what was $400,000-some in modest revenue in 2018 to almost $5 million in 2019.

Taking a look at where those revenues are coming from, break down substantial revenues for delivery of these lots in the land development segment. We expect to deliver the remaining 250 lots in 2020. So, if you take a look at that on our average price of $70,000, that may be $17 million, $18 million worth of runway for coming fiscal year.

Taking a look at the municipal tap revenue, we as of fiscal year-end had about 113 taps. We've done quite well since then. I'd say we'd probably take a look at a total of 200 taps. If you're looking for some guidance for 2020, 200 taps for our 2020. Taking a look at the industrial water sales, that kind of continues to go bump along. Colorado is a tortured relationship. We're trying to get in the way of oil and gas companies, and so some of the regulatory opportunities now where the state legislature pushed down the ability for local jurisdictions to regulate their oil and gas wells separate and independent of the Colorado Oil and Gas Commission. So, what we're seeing is it's a little bit longer to permit wells.

Fortunately, we find ourselves in a county that's oil and gas friendly. So, while I think we did maybe 25 wells in 2019, we'll probably see—and that was in line with what we did in 2018, maybe one well more than we did in 2018, but I think we'll probably see maybe a little softening of that for 2020 and maybe forecast 20 wells in that area. What this presents is sort of decades of opportunity, and I think you're looking at maybe each operator getting one or two rigs dedicated to the field, and so you sort of say, this number could be a substantial number over the next 30 years for us.

Then, our oil and gas royalties, we still are generating about $20,000 a month. So, still relatively modest, but we've only got one well into our formation and we did grant the operator that we have a lease relationship with a pad site for an additional 10 wells. So, we have some requirements and some timelines for them to construct those 10 wells.

The next two sheets, 17 will give you the balance sheet, growing the overall total assets of the company. Taking a look at the income statement, we're very proud of that 2019 income statement, really $0.20 a share on the income per diluted share, about $4.8 million income after taxes.

So, that'll conclude kind of the prepared remarks. What I'd like to do is open it up to the audience for some questions and answers. So, if the moderator can give you some instructions as to how to dial in and ask some questions, I'd be happy to take some questions.

Operator
Yes, of course. Thank you. The floor is now open for questions. [Operator instructions]. We do have our first question from Anthony Polak [ph]. Please state your question.

Q: Hi, Mark. Congratulations on the numbers. A couple of quick questions. First, can you describe the legal relationship between Pure Cycle and the municipalities that are going to be paying you back for these reimbursables? Are they the ones that are in direct contact with the customers? Do they do the billing? Do you do the billing yourself? How does that work?

Mark Harding – President, Chief Financial Officer, and Director
So, let me bifurcate that out between the utility side as well as the land development side. We're a wholesaler of water to a quasi-municipal political subdivision called the Rangeview Metro District. Then the Rangeview District contracts with us to operate, maintain, and do all the rebilling. So, we do all of that billing to those customers and we get 100% of the tap fee revenue and 98% of the usage revenue. So, that's how that relationship works with the water side.

On the land development side, what we have is what we call in Colorado developer districts. So, we have Sky Ranch Metropolitan Districts, and we have a number of those. Then those districts consolidate into the Sky Ranch Community Authority Board, so that's the Sky Ranch cab. When you read through our financial statements, you'll see references to those.

We control the board of directors for that, but it is a political subdivision of the State of Colorado. We sit on those boards by virtue of a land ownership provision. So, we own the land within Sky Ranch that allows us to sit on those boards. That's the taxing entity, so in Colorado what we have is a mechanism whereby growth must pay its own way. So, every development area will have something like what we have here, where it will have the jurisdictional areas and it will build the roads, the curbs, the gutters, the drainage, everything that's going to be attributable to providing homes in that area.

Then, those mill levees from the homes and the value, the assessed value for those improvements, then are qualified for public improvement reimbursables. So, that's the relationship where we're not the legal entity. It's a taxing legal entity from the customers, those customers as the municipality, as the community builds out, then they have an electorate, and then they can become elected officials of those districts and participate in that governance with us on those districts, and then have the ability.

Our mill levees are set on a predetermined area. If we need to increase them, we have to go back to the voter elective to increase those, and so that's kind of the relationship on the land development side between us and the municipalities.

Q: When do they reimburse you, when they start charging the real estate taxes, and then they can raise debt against that? Is there a timing lag? How can we understand that a little bit better?

Mark Harding – President, Chief Financial Officer, and Director
That's a great question. I'll break it up into three areas where people look at this. They can be very early in those financings where oftentimes the developer doesn't have the capital to start to development, so the way they would do that is they would say, I'm going to build this, and I'm going to have assessed value in a couple of years.

So what they do is they go to the bond market early, and they get very high interest rate because that would be a high-risk bond, and then they use those proceeds to plow that into some of that infrastructure. So, I would say that's an early financing.

Then, there's kind of a late-stage financing, where a developer would wait until the project is built out. They have got all the homes built, they've got all the assessed value, and then they bond it and then they would get a very low interest rate.

So, somewhere between those is the optimum one. That's where we looked at it is to say, okay where's the optimum scale for being far enough along into your development that you'll get a very favorable interest rate while at the same time be able to leverage the total assessed value that's going to be from your build out.

What we saw was that this thing was going very successful. The district retained City Corp, the municipal division of City Corp, to be able to come in and give a financial analysis of what the opportunity for bonding is. They came back and said, listen, this is a terrific, absorption here. You can go to market at any time, and you're not going to improve your interest rate by holding a couple of years just because you've got a lot of momentum going.

So, the board of directors sort of elected to have them go ahead and engage them to start that process. They're in that process right now, so pending a successful conclusion of that process, you'll see an announcement about some of those reimbursables coming back to us within this fiscal year.

Q: Awesome. Then one unrelated—first of all, thank you and much clearer. Then, an unrelated question, did I hear you say that in fiscal 2020 we should expect 200 tap connections?

Mark Harding – President, Chief Financial Officer, and Director
Yes.

Q: Okay. Alright. Thanks. That concludes my questions.

Operator
Thank you. Our next question comes from Dorsey Gardner [ph]. Please state your question.

Q: Hi, Mark, it's Dorsey.

Mark Harding – President, Chief Financial Officer, and Director
Hi, Dorsey.

Q: Hi. Will you comment on the tax situation? You have a loss carry forward, or what's the situation there?

Mark Harding – President, Chief Financial Officer, and Director
We're in that high quality problem. We're going to have to start using some of those. So, yes, we do have some NOLs that carry forward. We have about $7 million, is that about right? Okay, $2 million left. So, we've been whittling net tax provision down over the last few years.

I think carrying forward, we'll be using some of that in 2019, and then in 2020 we'll have the $2 million left. So, I think we're going to use up the $4 million almost $5 million. So, that's got like $7 million, that's where I had that placeholders that we had $7 million. We're going to use about $5 million of them up for the 2019, and then we'll have about $2 million left. Then we'll send our checks over to our illustrious president.

Q: Okay. Thank you.

Operator
Thank you. [Operator instructions]. We do have our next question from John Rosenberg. Please state your questions

Q: Yes, hi. Good afternoon. Hi, Mark. Thanks for taking my question.

Mark Harding – President, Chief Financial Officer, and Director
Hi, John.

Q: Getting back to the CAB, you guys had announced—congratulations on—well, you're in process financing. I pulled up some information. Could you tell me a little bit about you are looking at, or what will the CAB be issuing? I'm seeing some issues like it looks like a seven and five-eighths and a 5% coupon issue. Are you allowed to talk about that now or?

Mark Harding – President, Chief Financial Officer, and Director
Yes, yes. I can tell you what's been filed in the public market. So, there's a preliminary limited offering memorandum. You have to have acronyms in here, so we have a PLOM that's been filed, and the initial forecast was to be something like $10.8 million in senior bonds and then about $1.7 million in subordinate bonds.

The way the subordinate bonds work is in cascading revenue flows as the mill levees go to fund the senior bonds. Then, once those debt services are fully funded, then they go to fund the subordinate bonds. The relationship between the senior bonds and the subordinate bonds really are a function of buildup. So, if you issued late-stage bonds, where the community was fully built out, those would all be senior bonds. If you issued early-stage bonds, they would almost all be subordinate bonds because there's no senior bonds that have existing mill levy.

So, that's where we found ourselves kind of in that area that allowed us to have a good senior position and a relatively small subordinate position because of a very good visibility to build out and the number of connections and then the total assessed value.

So, then they go, they build all these things and once they have them, they put together that marketing memorandum. They go to the market and they see kind of where the market demand is for that. The interest rate sensitivities there are kind of estimates, and so if I look in my world to say, if we got 5%, that's kind of at expectation, and I'd be satisfied. If we got more than 5% interest rate, then maybe I look at it and say the market was a little weak and they were dialing back on the risk factor.

Then if we got less than 5%, I'd say the market really looked at our project with some favor and we're willing to pay a premium. So, we'll see how that prices out, and you'll see final numbers come to that PLOM, and those will be the actual interest rates.

Q: Okay. I see. Thank you. So, I'm looking at the coupons or the prospective coupons or two different structures. I don't know if they're the same. One has a call with a sinking fund provision, the others is to call provision. One is a seven and five-eighths, one's 5%. I was wondering what—they're dated—

<u>Mark Harding – President, Chief Financial Officer, and Director</u>
The seven and five-eighths.

Q: The 19th of this month in the memorandum. I was wondering what you intend to come to market with if you're looking at 5% money or maybe even a little bit less if the bonds trade up if they come issued above par or if you're looking at having the go-to-market for seven and five-eighths. You're telling me those are basically kind of markers out there right now.

<u>Mark Harding – President, Chief Financial Officer, and Director</u>
That's right. Those are placeholders.

Q: Okay, great. Alright, well thank you very much, and best of luck going forward. Thank you very much.

<u>Mark Harding – President, Chief Financial Officer, and Director</u>
Thank you.

<u>Operator</u>
Thank you. Our next question comes from Bill Cunningham. Please state your questions

Q: Hi, Mark. I have some questions on the bonds as well. The interest rate, how does that impact Pure Cycle? I assume the bonds are being serviced by the taxes by the homeowners. So, it seems if I'm understanding things correctly, that the interest rate doesn't really directly affect Pure Cycle in any manner. Is that correct?

<u>Mark Harding – President, Chief Financial Officer, and Director</u>
That is correct. So that's not our debt interest rate. That's going to be the municipality's debt interest rate, and it does have an indirect effect to us because if they get a lower interest rate on the same assessed value, then they have more bonding capacity. So, if the interest rate goes down, then they can go for more money with the same assessed value and pay more of the reimbursables.

Q: Okay.

Mark Harding – President, Chief Financial Officer, and Director
If you look at it, in this particular first phase, and let me drill down in a question that I'm pretty sure you're going to ask the next question, which is, how much of the first phase of reimbursables are we going to get back with this bond. We won't get them all back. We think we'll have about $25 million worth of reimbursables in this first phase, and we may only get back $10 million in this first phase.

That's because when you look at property taxes in Colorado, Colorado is what we call a sales tax incentive state, so we have very modest property tax, very modest income tax, but relatively high sales tax. So, when you look at where that revenue comes from for cities and municipalities, it's weighted to commercial development. In fact, we get four times the amount of revenue from the same AV in commercial than we do in residential.

So, while this first phase is just residential, and it really won't allow us to pay back all of the public improvements, we have a very large commercial that pays four times the amount of tax money on the same AV that will then catch up and pay for the residential components that were unfunded by property taxes.

So, we'll still have that balance accruing. That $25 million as we build out that first phase, and I'm just speaking hypothetically, if we get $10 million back on this first phase, just because they're round numbers, if we get $10 million back on this first phase, we will still have that $15 million that will continue to accrue interest as a reimbursable for future phases and future bond offerings.

Q: Okay. Now, this first $10 million, when the bonds are sold and you get reimbursed, is all of that reported as income to Pure Cycle?

Mark Harding – President, Chief Financial Officer, and Director
To the extent that we haven't already taken it out of inventory, it is. If we still have monies left in inventory, then we met it out against the inventory amount. So, you'll see some of that tax advantage there, but looking through, it really will wash out period-over-period because if it comes in our fiscal year, it all becomes taxable.

Q: Okay. So the full $25 million ultimately will stay—or whatever the exact number ends up being, in totality will be income to Pure Cycle, right?

Mark Harding – President, Chief Financial Officer, and Director
Correct. Particularly, if you look at the second $15 million, so the second $15 million we'll have recorded all of our basis in that first 506 lots, so that next $15 million is 100% income. It drops to the bottom line.

Q: Okay. Thank you.

Operator
There appears to be no more questions at this time.

Mark Harding – President, Chief Financial Officer, and Director
Okay. Well, I certainly want to encourage all of you if you think of a question that you didn't get in or you had some technical difficulties dialing in, don't hesitate to give me a call, or if you're listening to this on the replay, certainly reach out.

Some upcoming news, we'll have our shareholder meeting coming up in January. So, January 15th you'll see our proxy statement. We'll file that probably within the next couple of weeks. So, you'll see an announcement on our proxy about the shareholder meeting, the time, the location, and those sorts of things. If you're headed anywhere by Dodge, through Dodge, come by and see us. We'd love to meet you.

Then I just want to say, I want to really thank our board. I want to thank our management team for a really a strong effort putting together a great year-end. We've executed very well. I think certainly the builder market has been very biased. If the number of interests that I get from builders that aren't in our first phase are any indication of this, certainly Sky Ranch has made a significant splash in the Denver MSA, and we look to continue that success with our next filing.

We're in the late stages of our permits with that and we'd like to get those and kind of be in a position to start breaking ground on that sometime late next spring to be able to work the dirt, get those lots delivered, and then be in a position of delivering finished lots for spring of 2021 which should carry through sort of the build out of all the homes. We're going to deliver lots in 2020, but it'll take the builders a little bit to finish out building 506 homes out there, but we'd like to have a seamless transition and be able to carry forward to the next day. So, very exciting for the company, very exciting and rewarding for all of our shareholders. So, I want to thank you all for your support.

With that, I'll go ahead and sign out, and look forward to catching up with you all soon.

Operator
Thank you. This does conclude today's teleconference. We thank you for your participation. You may disconnect your lines at this time, and have a great day.