

# PURE CYCLE

a water and wastewater services company



**Sky Ranch**

**NASDAQ: PCYO**

Dear Shareholders:

It's been a great year! While there are the obvious metrics for this year's performance - record revenues, record profits, record growth - and I am pleased to report these results, there are many other achievements that may not be as obvious. As we embarked on our land development segment seeking to deliver finished lots to our homebuilder customers, we set a pretty ambitious goal of not only building a new Master Planned Community, but also building a new water and wastewater system. Starting a new project is generally more difficult than expanding an existing one, and we started three new projects simultaneously. As the year commenced, there was plenty of skepticism in the market. While our homebuilders were supportive by contracting to buy these new lots, we were in fact opening a new market along the I-70 corridor where market acceptance was not tested. Needless to say, we had our work cut out for us.

While our financial results are the score card for the year, I would like to share with you a bit about how we have built our organization over the past few years and introduce you to the real stars of the organization. We operate on the vertically integration ideology. By that I mean we have a talented team of engineers, led by a 40-year industry veteran Mr. Scott Lehman, who designs our water and wastewater systems. He not only makes sure they operate correctly, but he decides when, where and how big to build. Complementing our engineering staff, we have an experienced group of construction professionals, led by Mr. Raphael Meir, who have decades of construction experience and can operate the heavy equipment that makes difficult tasks attainable. Complementing our construction staff are a dedicated team of water and wastewater operators, led by Mr. Mark Whitlatch, who have decades of experience operating water and wastewater systems and placing systems into service. This integration allows us to have the field personnel who construct much of the components of our water and wastewater systems in direct contact with the engineers who design it, both of whom work with the professionals who operate the systems to collaborate to attain the best outcome. We are a water utility company and have built an excellent team of experienced professionals and have accumulated a valuable portfolio of water rights and other infrastructure through the years. However, starting construction at Sky Ranch required new builds to both our water and wastewater assets from individuals who are dedicated to getting it done right, and I could not be prouder of their work.

While we were confident that we could succeed building our utility assets, we had to do this at the same time as we were building a new Master Planned Community. This year marked the start of our land development segment where we contracted to deliver ready to build "finished" lots to homebuilders. Our land development activities are managed by a 20-year land veteran, Mr. Dirk Lashnits.

Developing finished lots is a massive undertaking and requires extensive planning and coordination among several different contractors from managing the dirt work, the



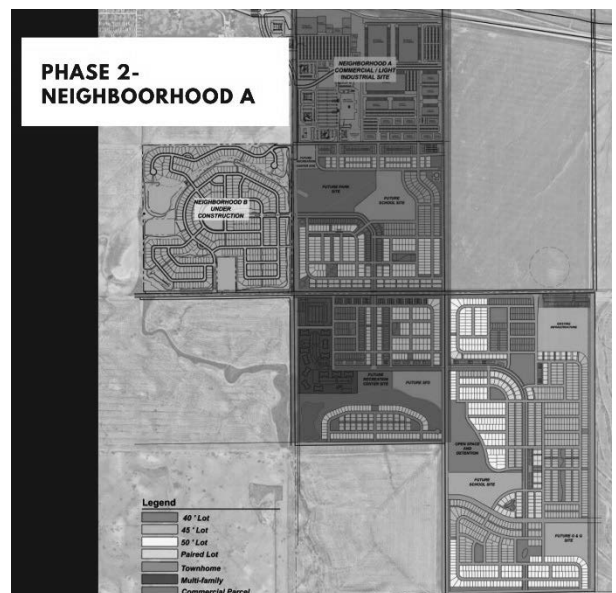
wet and dry utilities, streets, curbs, drainage system, parks, open spaces, trails, entry roadway, traffic system, community lighting, and many more details all the way down to the location of the mail boxes. And doing all this at the same time we were building a new water and wastewater system. Those of you who were able to visit the site witnessed that it was a massive undertaking of equipment and personnel.

I can tell you our dedicated team worked their tails off to meet our objective of delivering 150 finished lots by our fiscal year end. While we surpassed this goal by nearly 70%, delivering 255 finished lots, I would be lying if I said it all went smoothly. 2019 was a year in which mother nature was not kind. We had record snow fall this past winter and more spring rain, and heavier rain, than we've seen in 30 years, which made for challenging construction conditions. Credit truly goes to our construction team, who was able to clean up washed out messes allowing our contractors to get back to work quicker than at other sites throughout the spring rains. Not only have we been able to deliver 170% of our anticipated lots, we were able to deliver these lots within budget during extraordinary conditions, a truly great year.

The result - our homebuilders had finished lots at Sky Ranch when most of their other projects were still recovering from a wet first half of the year. Having finished lots is only part of our success, we had to deliver an extraordinary community where people wanted to live. I credit our land planning team at PCS Inc., who created a well-planned, pedestrian friendly community that provided the look and feel of a beautiful Master Planned Community at a price allowing for the delivery of entry level homes, in what has been described as the most affordable Master Planned Community in the Denver market. Home sales at Sky Ranch have exceeded all our builder's projections, and all three of our builders have asked to accelerate their lot purchases and requested us to deliver their remaining contracted lots as quickly as we can. In some cases, this will accelerate the closing of lots that were originally contracted to be delivery in 2022 into 2020.

While our land development team delivered results, so too did our utility team, somehow staying out of the way of all our land construction contractors to deliver our water system and a state of the art wastewater reclamation facility that treats 100% of the wastewater to a high standard for re-use in Sky Ranch's parks and open spaces. This water reclamation facility recycles and reuses 100% of the community's wastewater for outdoor irrigation, which lowers our initial water requirement per connection. I am so very proud of our team of professionals and their stewardship of our shareholders' invested capital to deliver these assets ahead of schedule and within budget. They are the ones who deserve the true credit for this year's results.

Not wasting time resting on our laurels, we embark on 2020 with full sails, excess capacity in both our water and wastewater systems, and champing at the bit, as are our three homebuilders and nearly a dozen new builders, to break ground on our second phase, which is planned to include a broader product mix of residential offerings, including some multifamily units, as well as 150 acres of commercial land near the Interstate. Expanding Sky Ranch is expected to be easier than starting construction, and having excess capacity in our utility assets will allow for accelerated financial results. I pen this letter with the humble appreciation of our team, our Board of Directors who provide guidance and direction, and our loyal shareholders, new and old, who have supported our investments through the years. We look forward to many more great years.



Very kindly yours,

Mark Harding

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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, 2019

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 Number)

34501 E. Quincy Avenue, Bldg. 34, Watkins, CO

(Address of principal executive offices)

80137

(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)

PCYO

(Trading Symbol(s))

The NASDAQ Stock Market

(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 every Interactive Data File required to be submitted 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 such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the 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: \$171,975,455

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: November 8, 2019 - 23,826,598

#### **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 2020, which will be filed with the Securities and Exchange Commission within 120 days of the close of the fiscal year ended August 31, 2019.

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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 Annual Report on 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, on the Lowry Range, or in the surrounding areas;
- 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 and second phase of development at Sky Ranch;
- the timing for the completion of construction of finished lots at Sky Ranch;
- the number of lots for which delivery is expected in fiscal years 2020 and 2021;
- estimated costs of earthwork, erosion control, streets, drainage and landscaping at Sky Ranch;
- the estimated amount of reimbursable costs for Sky Ranch;
- capital required and costs to develop the first and second phase of Sky Ranch;
- estimated costs of improvements to be funded by Pure Cycle and constructed by the Sky Ranch Community Authority Board;
- anticipated revenues and margins from development of our Sky Ranch property;
- estimated time period for build out of Sky Ranch and sufficiency of tap fees to fund infrastructure costs;
- the impact of any 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;
- costs and plans for treatment of water and wastewater;
- plans to use raw water, effluent water or reclaimed water for agricultural and irrigation uses;
- participation in regional water projects, including “WISE” and the timing and availability of water from, and projected costs related to, WISE;
- our ability to assist Colorado “Front Range” water providers in meeting current and future water needs;
- timing of and interpretation of royalties to the State Board of Land Commissioners;
- 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;
- 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 use the tool when we drill new water wells and to market the tool to area water providers;
- plans to drill water walls into aquifers located beneath the Lowry Range and the timing and estimated costs of such a build out;
- 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 and estimated value of certain farms, and plans with respect to related mineral interests;
- service life of constructed facilities;
- use of third parties to construct water and wastewater facilities and Sky Ranch lot improvements;
- plans to utilize fixed-price contracts;
- payment of amounts due from the Rangeview District and the Sky Ranch Districts;
- capital expenditures for investing in expenses and assets of the Rangeview 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;
- 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;
- our plans to remediate material weaknesses in our internal control over financial reporting; 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;
- changes in employment levels, job and personal income growth and household debt-to-income levels;
- changes in consumer confidence generally and confidence of potential homebuyers in particular;
- the ability of existing homeowners to sell their existing homes at prices that are acceptable to them;
- changes in the supply of available new or existing homes and other housing alternatives, such as apartments and other residential rental property;
- 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, including with respect to land use and environmental and tax matters;
- changes in interest rates;
- private and federal mortgage financing programs and lending practices;
- 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;
- unauthorized access to confidential information and data on our information technology systems and security and data breaches; 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.

## 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.
- Non-Tributary Groundwater – groundwater located outside the boundaries of any designated groundwater basins in existence on January 1, 1985, the withdrawal of which will not, within one hundred years of continuous withdrawal, deplete the flow of a natural stream at an annual rate greater than one-tenth of one percent of the annual rate of withdrawal.
- Not Non-Tributary Groundwater – statutorily defined as groundwater located within those portions of the Dawson, Denver, Arapahoe, and Laramie Fox-Hill aquifers outside of designated basins that does not meet the definition of “non-tributary.”
- 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.
- SFE – a single family equivalent unit. 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.

## PART I

### Item 1 – Business

Pure Cycle Corporation, a Colorado corporation (“we,” “us” or “our”), is a wholesale water and wastewater company and land development company that:

- provides wholesale water and wastewater services;
- designs, constructs, operates and maintains water and wastewater systems;
- supplies untreated water for hydraulic fracturing and other commercial/industrial uses; and
- operates a land development segment that is developing a master planned mixed-use community.

Our wholesale water and wastewater segment provides wholesale water and wastewater services to customers within our exclusive service area and elsewhere in the Denver Metropolitan Area. We own or control water rights we use to provide domestic, irrigation, and raw water to our customers (including surface water, groundwater, reclaimed water rights and water storage rights). We own or control the infrastructure required to (i) withdraw, treat, store and deliver water (such as wells, diversion structures, pipelines, reservoirs and treatment facilities); (ii) collect, treat, store and reuse wastewater; and (iii) treat and deliver reclaimed water for irrigation use. We are principally targeting the “I-70 corridor,” a largely undeveloped area located east of downtown Denver and south of Denver International Airport along Interstate 70, as we expect the I-70 corridor to experience substantial growth over the next 30 years.

We provide untreated wholesale water services predominantly to industrial customers for various purposes and to oil and gas companies for hydraulic fracturing on properties located within or adjacent to our service areas. Oil and gas operators have leased more than 135,000 acres within and adjacent to our service areas to explore and develop oil and gas interests in the oil-rich Niobrara and other formations. We have capitalized on the need for significant water supplies for hydraulic fracturing in proximity to our water supplies and infrastructure. In addition, we provide wholesale water and wastewater services to local governmental entities that in turn provide residential and commercial water and wastewater services to communities along the eastern slope of Colorado in the area referred to as the “Front Range,” extending essentially from Fort Collins on the north to Colorado Springs on the south. Our largest customer is the Rangeview Metropolitan District (the “Rangeview District”), which is a quasi-municipal political subdivision of the State of Colorado. We have the exclusive right to provide wholesale water and wastewater services to the Rangeview District and its end-use customers pursuant to the “Rangeview Water Agreements” and the “Non-Lowry Service Agreement” (each as defined below). Through the Rangeview District, we currently provide wholesale service to 462 SFE water connections and 214 SFE wastewater connections located in the Rangeview District’s service area of southeastern metropolitan Denver in an area called the Lowry Range and other nearby areas where we have acquired service rights.

In addition to our water and wastewater operations, we are developing approximately 930 acres of land we own along Denver’s I-70 corridor as a master planned community known as Sky Ranch. In June 2017, we entered into agreements to sell a total of 506 residential lots at Sky Ranch to three national home builders. Our agreements with our home builder customers follow one of two formats; one known as a lot delivery agreement whereby we receive progress payments from two builders for certain delivery milestones when completing a finished lot, and second a finished lot delivery agreement where we are paid by one builder as we deliver a completed finished lot. Beginning in March of 2018, we began receiving payments from builders pursuant to our agreements for the construction of finished lots. As of the close of our fiscal year ended August 31, 2019, we have delivered and have been paid for the delivery of 255 finished lots.

Pursuant to agreements with the Rangeview District, we are the exclusive provider of wholesale water and wastewater services to the residents of Sky Ranch. As of August 31, 2019, we sold 113 water and wastewater tap fees and are providing water and wastewater services to customers at Sky Ranch.

Pure Cycle Corporation was incorporated in Delaware in 1976 and reincorporated in Colorado in 2008. Unless otherwise specified or the context otherwise requires, all references to “we,” “us,” or “our” are to Pure Cycle Corporation and its subsidiaries on a consolidated basis. Pure Cycle’s common stock trades on The NASDAQ Stock Market under the ticker symbol “PCYO.”

### **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 \$46.9 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**

<b>Water Source</b>	<b>Groundwater (acre feet)</b>
Lowry (Rangeview Water Supply)	
Export (1)	11,650
Non-Export (1)	12,035
Fairgrounds	321
Sky Ranch	828
	<u>24,834</u>
	<b>Surface Water (acre feet)</b>
Lowry (1)	3,300
Lost Creek Supply (2)	300
WISE	500
	<u>4,100</u>
	<b>Other Water (acre feet)</b>
Lost Creek Supply (2)	<u>220</u>

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

(2) In August 2019, we acquired over 800 acre feet of tributary groundwater, approximately 150 acre feet of Henrylyn surface water (which is not usable in our service areas) and approximately 70 acre feet of non-tributary groundwater. Based on engineering estimates, we believe that the historic consumptive use of the tributary groundwater will be approximately 300 acre feet per year, which is the amount included under Surface Water attributable to the Lost Creek Supply in the table above. Henrylyn is a statutory irrigation district that owns its water rights in trust for its landowners.

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 follow.

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



## **Rangeview Water Supply and the Lowry Range**

***Our Rangeview Water*** – We own or control approximately 26,985 acre feet of tributary surface water, non-tributary groundwater and not non-tributary groundwater, and approximately 26,000 acre feet of adjudicated reservoir sites that we refer to as our “Rangeview Water Supply” and an additional approximately 2,200 acre feet of water that is not part of our Rangeview Water Supply. Our water is principally 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.

***Rangeview Water Agreements*** – 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 Rangeview District, which was superseded by the 2014 Amended and Restated Lease Agreement, dated July 10, 2014 (the “Lease”), among the Land Board, the Rangeview 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 Rangeview District (the “Export Agreement”); and
- (iii) The 1996 Service Agreement between us and the Rangeview District for the provision of water service to the Rangeview District’s customers located on the Lowry Range, which was superseded by the Amended and Restated Service Agreement, dated July 11, 2014 (the “Lowry Service Agreement”), between us and the Rangeview District.

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

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

Pursuant to the Rangeview Water Agreements, we design, construct, operate and maintain the Rangeview District’s water and wastewater systems to allow the Rangeview District to provide water and wastewater service to its customers located within the Rangeview District’s service area at the Lowry Range and other approved areas. 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 Rangeview 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 leased water (which excludes Export Water) to customers will revert to the Land Board, with the Rangeview District retaining ownership of the wastewater facilities and the water system and related facilities used to deliver Export Water and other water to customers off the Lowry Range. 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 Rangeview District and other governmental entities and industrial and commercial customers.

Of the total 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 water to customers either on or off the Lowry Range. The Rangeview Water Agreements also grant us the right to use surface reservoir capacity to provide water service to customers both on and off 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 Rangeview 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 Rangeview 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 Rangeview District is governed by an elected board of directors. Eligible voters and persons eligible to serve as directors of the Rangeview District must own an interest in property within the boundaries of the Rangeview District. We own certain rights and real property interests which encompass the current boundaries of the Rangeview District. The current directors of the Rangeview District are Mark W. Harding (our President, Chief Financial Officer and a director), Scott E. Lehman (a Pure Cycle employee), and Dirk Lashnits (a Pure Cycle employee), and one independent board member. 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. Lashnits have all elected to forego these payments.

**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, whether the customer is a public or private entity, and the location of the customer. The Land Board does not receive a royalty from wastewater services.

**Water Customers** – When we develop, operate and deliver water service utilizing water from our Rangeview Water Supply, payments from customers generate royalties to the Land Board at a rate of 12% of gross revenues from private customers and customers on the Lowry Range and 10% 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 12% of gross revenues, 50% of the collective net profits (ours and the Rangeview 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, except for the sale of any taps to Sky Ranch, at the rate of two percent of the gross amount received from the sale of a water tap. Escalated royalties would be owed if we were to sell our Export Water outright rather than delivering water service. We do not currently anticipate selling our Export Water.

**Annual Production Fee** – We are also required to pay the Land Board a minimum annual water production fee of \$45,600 per year, which is to be credited against future royalties.

**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 water supplies on behalf of its members, including the Rangeview District. SMWSA members include 14 Denver area water providers in Arapahoe and Douglas Counties. Pursuant to certain agreements between the Rangeview District and us, we agreed to provide funding to enable the Rangeview District to acquire rights to water projects undertaken by SMWSA, including rights to water supplied pursuant to the cooperative water project known as “WISE”, 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 South Metro WISE Authority, consisting of the Rangeview District and nine other SMWSA members (“SMWA”), 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”). In exchange for funding the Rangeview District’s obligations in WISE, we have the sole right to use and reuse the Rangeview District’s approximate 7% share of the WISE water and infrastructure to provide water service to the Rangeview District’s customers and to receive the revenue from such service. Our current WISE subscription entitles us to approximately three million gallons per day of transmission pipeline capacity and 500 acre feet per year of water. In accordance with certain financing agreements, to date we have provided approximately \$3.5 million of financing to the Rangeview District to fund its obligation to purchase 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 Rangeview 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**

	<b>For the Fiscal Years Ended August 31,</b>				
	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>
Subscription (Operations)	\$ 44,235	\$ 32,033	\$ 32,033	\$ 32,033	\$ 32,033
Water Deliveries	430,350	858,000	858,000	858,000	858,000
Capital (Infrastructure)	2,296,138	50,000	50,000	50,000	50,000
Other	55,000	55,000	55,000	55,000	55,000
	<u>\$ 2,825,723</u>	<u>\$ 995,033</u>	<u>\$ 995,033</u>	<u>\$ 995,033</u>	<u>\$ 995,033</u>

**East Cherry Creek Valley System** – Pursuant to a 1982 agreement, the Rangeview 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, 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 2013 through December 31, 2020 and will decrease to \$3,000 per month beginning 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. In addition, the ECCV system costs us approximately \$12,500 per month to maintain.

**Revenues from our Water Supply** – We generate revenues through our wholesale water and wastewater operations predominantly from three sources: (i) monthly water usage and wastewater treatment fees, (ii) one-time water and wastewater tap fees and construction



fees/Special Facility funding, 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 Rangeview 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 Water Usage and Wastewater Treatment 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 C:

**Table C – Lowry Range Tiered Water Usage Pricing Structure**

	<u>Price (\$ per thousand gallons)</u>
Base charge per SFE	\$ 32.74
0 gallons to 15,000 gallons	\$ 4.63
15,001 gallons to 30,000 gallons	\$ 8.10
30,001 gallons and above	\$ 9.95

The figures in Table C reflect the amounts charged to the Rangeview District’s end-use customers on the Lowry Range. In exchange for providing water service to the Rangeview District’s Lowry Range customers, we receive 98% of the usage charges received by the Rangeview 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*).

The amounts charged by the Rangeview District to its end-use customers off the Lowry Range are determined pursuant to the Rangeview District’s service agreements with such customers and such rates may vary. In exchange for providing water service to the Rangeview District’s customers off the Lowry Range, we receive 98% of the usage charges received by the Rangeview District relating to water services after deducting any required royalty to the Land Board. The royalty to the Land Board is required for water service provided utilizing our Rangeview Water Supply, which includes most of our current customers off the Lowry Range except those at the Elbert & Highway 86 Commercial District (“Wild Pointe”).

In addition to the tiered water usage pricing structure, we currently charge a hydrant rate of \$13.00 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.

In exchange for providing wastewater services, we receive 90% of the Rangeview District’s monthly wastewater treatment fees, as well as the right to use or sell the reclaimed water.

- (ii) Water and Wastewater Tap Fees and Construction Fees/Special Facility Funding – 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 acquiring water rights.

The Rangeview District’s 2019 water tap fees are \$26,675 per SFE, and its wastewater tap fees are \$4,659.

In exchange for providing water service to the Rangeview District’s customers on the Lowry Range, we receive 100% of the Rangeview District’s tap fees after deducting the two percent royalty to the Land Board described above. If water taps are sold to customers not located on the Lowry Range that are to be serviced utilizing the Rangeview Water Supply (other than taps to Sky Ranch, which are exempt), the two percent royalty to the Land Board is deducted from the amount we receive. In exchange for providing wastewater services, whether to customers on or off the Lowry Range, we receive 100% of the Rangeview 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.

**Water Sales for Fracking**

We provide water for hydraulic fracturing (“fracking”) of oil and gas wells being developed in the Niobrara Formation around our service area and our Sky Ranch property. Oil and gas drilling in our area is affected by the price of oil, state, local and federal government regulations and the number of wells drilled and fracked can vary from year to year. Each well developed in the Niobrara Formation

utilizes between 10 and 20 million gallons of water to drill and frack, which equates to selling water to between approximately 100 and 200 homes for an entire year.

Water revenues from sales of water for the construction of well sites, drilling and fracking wells developed in the Niobrara Formation were approximately \$4,238,300 and \$4,044,300 during the fiscal years ended August 31, 2019 and 2018, respectively. With a large percentage of the acreage surrounding the Lowry Range in Arapahoe, Adams, Elbert, and portions of Douglas Counties already leased by oil companies, we anticipate providing additional water for drilling and fracking of oil and gas wells in the future. Previously, nearly all oil and gas development was attributable to our largest fracking customer ConocoPhillips Company (“ConocoPhillips”). However, in recent years, there have been three other oil and gas companies acquiring lease interests in the area, and each of these companies has drilled and fracked wells in the area. We anticipate continued development of oil and gas wells at the Lowry Range, Sky Ranch and the surrounding area by multiple operators. See *“Our water sales for the past two years have been highly concentrated among companies providing fracking services to the oil and gas industry, and such sales can fluctuate significantly”*, *“The enactment of Senate Bill 19-181 “Protect Public Welfare Oil and Gas Operations” increased the regulatory authority of local governments in Colorado over facilities siting and surface impacts of oil and gas development, which could have an adverse effect on our water sales to the oil and gas industry for hydraulic fracturing (“fracking”) and demand for new homes at Sky Ranch”* and *“Our land development segment may be subject to risks related to oil and gas operations in the vicinity of our Sky Ranch development, which could have an adverse impact on the marketability and/or value of our Sky Ranch property”* in *Item 1A – Risk Factors* of this Annual Report on Form 10-K.

### **Service to Customers Not on the Lowry Range**

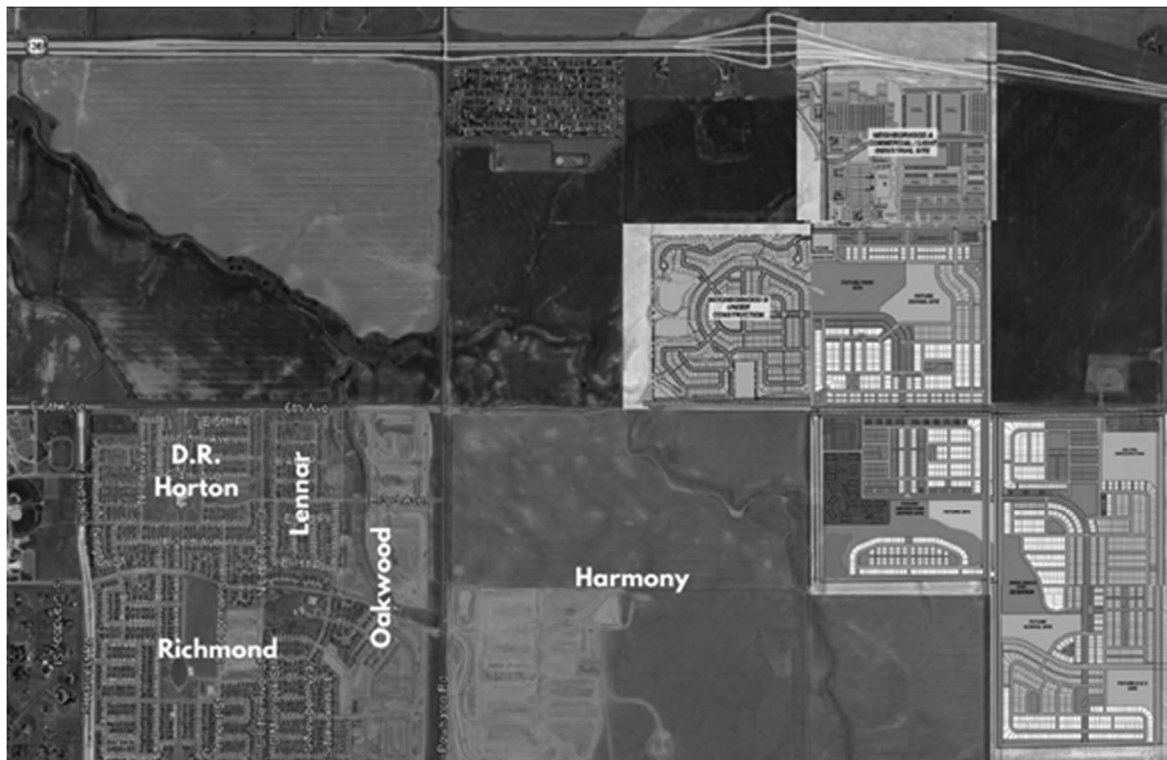
In addition to our Lowry Range service agreements, we have an agreement with the Rangeview District to provide exclusive water and wastewater service, including the design, construction, operation and maintenance of water and wastewater systems to serve the Rangeview District’s customers located outside the Lowry Range service area (e.g. Wild Pointe and Sky Ranch) (the “Non-Lowry Service Agreement”). In exchange for providing water and wastewater services to the Rangeview District’s customers that are not on the Lowry Range, we receive 100% of water and wastewater tap fees, 98% of the water usage fees, and 90% of the monthly wastewater service and usage fees received by the Rangeview District from these customers, after deduction of royalties due to the Land Board, if applicable. See Rangeview Water Supply and Lowry Range – *Land Board Royalties* above. The water usage fees to be collected for service at Sky Ranch may be subject to the Land Board royalty.

**Wild Pointe – Elbert & Highway 86 Commercial Metropolitan District** – In 2017, we entered into an agreement with the Rangeview District, which had entered into an agreement with Elbert & Highway 86 Commercial Metropolitan District (the “Elbert 86 District”) to operate and maintain a water system for residential and commercial customers at the Wild Pointe development in Elbert County. The water system includes two deep water wells, a pump station, treatment facility, storage facility, over eight miles of transmission lines, and approximately 457 acre feet of water rights serving the development. We provided \$1.6 million in funding to acquire the exclusive rights to operate and maintain all the water facilities in exchange for payment of the remaining residential and commercial tap fees and annual water use fees. Service to Wild Pointe is governed by the Non-Lowry Service Agreement.

**Sky Ranch Water and Wastewater Service** – As described in more detail below, we are developing approximately 930 acres of land we own as a master planned community known as Sky Ranch. Pursuant to the Sky Ranch Water and Wastewater Service Agreement, dated June 19, 2017, between PCY Holdings, LLC, our wholly owned subsidiary and the owner of the Sky Ranch property (“PCY Holdings”), and the Rangeview District, PCY Holdings agreed to construct certain facilities necessary to provide water and wastewater service to Sky Ranch, and the Rangeview District agreed to provide water and wastewater services for the Sky Ranch development. Pursuant to the Non-Lowry Service Agreement, we are the exclusive provider of water and wastewater services to future residents of the Sky Ranch development.

### **Sky Ranch Development**

In 2010, we purchased approximately 930 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 approximately 5,000 SFEs. Sky Ranch is zoned for 3,200 homes and over 2.0 million square feet of commercial, retail and light industrial development. Sky Ranch will develop in multiple phases over a number of years. Our first phase of 151 acres is platted for 506 detached single-family residential lots. We have entered into purchase and sale agreements (described in more detail below) with three national home builders pursuant to which the Company agreed to sell, and the builders agreed to purchase, the initial 506 residential lots at the property. We began construction of 255 residential lots for entry-level housing (houses costing in the \$375,000 to \$470,000 range) on March 1, 2018, and as of August 31, 2019 we have delivered and received payment for 255 finished lots. We expect to deliver an additional 200 lots in 2020 and the balance of the lots thereafter depending on home sales. We estimate that build out of our initial 506 lots will take between three and four years. We have leased the oil and gas minerals underlying the land to a major independent exploration and production company.



In June 2017, we entered into purchase and sale agreements and related agreements (collectively, the “Builder Contracts”) with three separate home builders pursuant to which we agreed to sell, and each builder agreed to purchase, a certain number (totaling 506) of single-family, detached residential lots at Sky Ranch. We are developing finished lots for each of the three home builders (which are lots on which homes are ready to be built that include roads, curbs, wet and dry utilities, storm drains and other improvements). Each builder is required to purchase water and sewer taps for the lots from the Rangeview District, the cost of which depends on the size of the lot, the size of the house, and the amount of irrigated turf. Pursuant to the Non-Lowry Service Agreement, we will receive all of the water tap fees and wastewater tap fees. We will receive the monthly service fees and usage fees for water and wastewater services received by the Rangeview District from customers at Sky Ranch net of fees retained by the Rangeview District noted above.

As of August 31, 2019, we have completed and sold 255 finished lots to our home builder customers, and have received payments of \$18,086,200, \$14,094,900 of which we have recognized as revenues. In addition, we have completed grading, water, sewer, and storm drain improvements for the remaining 251 lots and expect to finish the remaining improvements during fiscal year 2020. All three of our home builder customers have accelerated their purchases of finished lots from their original agreements, and we expect to close on an additional 200 finished lots in 2020 and on the remaining 51 lots in early fiscal year 2021.

Pursuant to the Builder Contracts, we must cause the Rangeview District to install and construct off-site infrastructure improvements (i.e., a wastewater reclamation facility and wholesale water facilities) for the provision of water and wastewater service to the property. We have substantially completed all of the off-site infrastructure improvements for the initial 506 residential lots.

Public improvements, such as roads, parks, and water and sanitary sewer mains, that will be shared by all homeowners in the development and not specific to a finished lot will ultimately be owned by the Rangeview District, the Sky Ranch Districts (as defined below) or the Sky Ranch Community Authority Board (the “CAB”). Upon completion of certain public improvements and acceptance by the Sky Ranch Districts or the CAB, we will be entitled to reimbursement for the verified costs incurred with respect to such improvements. We estimate that the total capital required to develop lots in the first phase (506 lots) of Sky Ranch will be approximately \$35 million, which includes estimated reimbursable costs of approximately \$29 million that will be reimbursable to us by the CAB, and that lot sales to home builders will generate approximately \$36 million in revenues, providing a margin before reimbursements on lots of approximately \$1 million. The Company and the CAB have agreed that no payment is required by the CAB with respect to reimbursable costs unless and until the CAB and/or the Sky Ranch Districts issue bonds in an amount sufficient to reimburse us for all or a portion of advances provided or expenses incurred for reimbursables. Due to this contingency, the reimbursable costs will be included in *Inventories* and subsequently expensed through *Land development construction costs* until the point in time when bonding is obtained and the CAB reimburses the Company for the public improvements. The portion of the reimbursable costs that are repaid will then be recorded as a note receivable and will reduce any remaining capitalized expenses to the extent available. Any reimbursable costs repaid in excess of capitalized expenses will be recognized as other income.

Utility revenues are derived from tap fees (which vary depending on lot size, house size, and amount of irrigated turf) and usage fees (which are monthly water usage and wastewater treatment fees). Our current Sky Ranch water tap fees are \$26,675 (per SFE), and wastewater taps fees are \$4,659 (per SFE).

We are designing and engineering our second phase, which will include approximately 320 acres of residential development and 155 acres of commercial, retail, and industrial development along the I-70 frontage. We expect to have multiple phases being developed concurrently and expect the development of the Sky Ranch project to occur over 10–14 years, depending on demand.

***Sky Ranch Metropolitan District Nos. 1, 3, 4, and 5*** – The Sky Ranch Metropolitan District Nos. 1, 3, 4 and 5 are quasi-municipal corporations and political subdivisions of Colorado formed in 2004 for the purpose of providing service to the approximately 930 acres of the Sky Ranch property (the “Sky Ranch Districts”). The Sky Ranch Districts are governed by an elected board of directors. Eligible voters and persons eligible to serve as directors of the Sky Ranch Districts 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 districts. The current directors of the districts are Mark W. Harding (our President, Chief Financial Officer and a director), Scott E. Lehman (a Pure Cycle employee), and Dirk Lashnits (a Pure Cycle employee), and one independent board member. 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. Lashnits have all elected to forego these payments.

### **Sky Ranch Community Authority Board**

Pursuant to a certain Community Authority Board Establishment Agreement, as the same may be amended from time to time, Sky Ranch Metropolitan District No. 1 and Sky Ranch Metropolitan District No. 5 formed the CAB to, among other things, design, construct, finance, operate and maintain certain public improvements for the benefit of the property within the boundaries and/or service area of the Sky Ranch Districts. In order for the public improvements to be constructed and/or acquired, it is necessary for each Sky Ranch District, directly or through the CAB, to be able to fund the improvements and pay its ongoing operations and maintenance expenses related to the provision of services that benefit the property. We entered into agreements, first with Sky Ranch Metropolitan District No. 5 in 2014 and later with the CAB, requiring us to fund expenses related to the construction of an agreed upon list of public improvements for the Sky Ranch property.

In September 2018 and effective as of November 13, 2017, the parties consolidated and superseded these previous agreements with one new agreement pursuant to which:

- the CAB agreed to repay the amounts owed by Sky Ranch Metropolitan District No. 5 to Pure Cycle, and the previous agreement entered into between Pure Cycle and Sky Ranch Metropolitan District No. 5 in 2014 was terminated;
- previous agreements between the CAB and Pure Cycle were terminated;
- the CAB acknowledged all amounts owed to Pure Cycle under the terminated agreements, as well as amounts we incurred to finance the formation of the CAB; and
- Pure Cycle agreed to fund expenses related to the construction of an agreed upon list of improvements to be constructed by the CAB with an estimated cost of \$30 million (including improvements already funded) on an as-needed basis for calendar years 2018–2023.

Advances and verified costs expended by us for expenses related to the construction of the agreed upon improvements are reimbursable to us by the CAB. All amounts owed under the terminated agreements and each reimbursable expense incurred under the new agreement accrues interest at a rate of 6% per annum from the time funds are advanced by us to the CAB or costs are incurred by us for expenses related to the construction of improvements, as applicable. No repayment is required of the CAB for advances made to the CAB or expenses incurred related to the construction of improvements unless and until the CAB and/or Sky Ranch Districts issue bonds in an amount sufficient to reimburse us for all or a portion of advances or other expenses incurred. The CAB agrees to exercise reasonable efforts to issue bonds to reimburse us subject to certain limitations. In addition, the CAB agrees to utilize any available moneys not otherwise pledged to payment of debt, used for operation and maintenance expenses, or otherwise encumbered, to reimburse us. Any advances or expenses not paid or reimbursed by the CAB by December 31, 2058, shall be deemed forever discharged and satisfied in full. As of August 31, 2019, we have advanced the CAB approximately \$20 million for the construction of public improvements, including improvements with respect to earthwork, erosion control, streets, drainage, and landscaping and expect to fund an additional estimated \$8.4 million in buildout costs associated with our first 506 lots of development that we expect will be reimbursable by the CAB.

The current directors of the CAB are Mark W. Harding (our President, Chief Financial Officer and a director), Scott E. Lehman (a Pure Cycle employee), and Dirk Lashnits (a Pure Cycle employee), and one independent board member. 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. Lashnits have all elected to forego these payments.

## Oil and Gas Leases



In 2011, we entered into a three-year Oil and Gas Lease (the “O&G Lease”) and Surface Use and Damage Agreement and received an up-front payment and a 20% of gross proceeds royalty (less certain taxes) from the sale of any oil and gas produced from the approximately 634 acres of mineral estate we own at Sky Ranch. In 2014, the O&G Lease was extended for an additional two (2) years. The O&G Lease is now held by production, and we have been receiving royalties from the oil and gas production from two wells drilled within our mineral interest. During the fiscal year ended August 31, 2019, we received \$148,300 in royalties attributable to these two wells.

In September 2017, we entered into a three-year Paid-Up Oil and Gas Lease with Bison Oil and Gas, LLP (the “Bison Lease”) for the purpose of exploring for, developing, producing, and marketing oil and gas from 40 acres of mineral estate we own adjacent to the Lowry Range, and we received an up-front payment of \$167,200.

In July 2019, we entered into an Agreement on Locations of Oil and Gas Operations covering approximately 16 acres with the operator of the O&G Lease (the “OGO”). The Company received an up-front payment of \$573,700 in fiscal 2019 for the OGO, which will be recognized

as income on a straight-line basis over three years (the term of the agreement). If after three years the operator has not spud at least one well on the oil and gas operations area, the operator may extend the right to the OGO one additional year by paying us \$75,000. The operator may only extend the OGO for two additional years for a total of five years. We recognized lease income of \$26,200 during the fiscal year ended August 31, 2019 related to the up-front payment received pursuant to the OGO. As of August 31, 2019, we have deferred revenues of \$547,500 related to the OGO that will be recognized into income ratably through July 2022.

## Arkansas River Land and Minerals

We own three farms totaling 700 acres in the Arkansas River Valley. The farms were acquired in order to correct dry-up covenant issues related to water-only farms, and we currently lease all three farms for dry land grazing. We intend to sell the farms in due course and have classified the farms as long-term investments. 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.

## Significant Customers

### *Water and Wastewater*

Our wholesale water and wastewater use sales to the Rangeview District pursuant to the Rangeview Water Agreements accounted for 5%, 6% and 26% of our total water revenues for the fiscal years ended August 31, 2019, 2018 and 2017, respectively. The Rangeview District has one significant customer, the Ridgeview Youth Services Center (“Ridgeview”). Pursuant to our Rangeview Water Agreements, we are providing water and wastewater services to Ridgeview on behalf of the Rangeview District. Ridgeview accounted for 3%, 4% and 21% of our total water revenues for the fiscal years ended August 31, 2019, 2018 and 2017, respectively.

Our industrial water sales (i) directly and indirectly to ConocoPhillips accounted for approximately 74%, 68% and 30% and (ii) to other oil and gas operators accounted for approximately 16%, 21% and 25%, of our total water revenues for the fiscal years ended August 31, 2019, 2018 and 2017 respectively.

### *Land Development*

Revenues from three customers represented 100% of the Company’s land development revenues for the fiscal year ended August 31, 2019. Richmond American Homes of Colorado, Inc. represented 32%, and each of KB Home Colorado Inc. and Taylor Morrison of Colorado, Inc. represented 34% of the Company’s land development revenues for the fiscal year ended August 31, 2019. Revenues from two customers represented 98% of the Company’s land development revenues for the fiscal year ended August 31, 2018. Richmond American Homes of Colorado, Inc. represented 66% and Taylor Morrison of Colorado, Inc. represented 32% of the Company’s land development revenues for the fiscal year ended August 31, 2018. No revenues were recognized from the Company’s land development activities for the fiscal year ended August 31, 2017.

## 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/or new water supplies. We believe that 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 treatment 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 by managing capital investments 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 and 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 that 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 seek opportunities for developing water supplies and water storage opportunities with other 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. It is expected that each well will 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 \$850 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 at least 50 years, 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 2019, we invested approximately \$14.1 million in plant and facilities that interconnect the Rangeview District, WISE, and Sky Ranch water and wastewater systems and provide water and wastewater services to our customers. We expect to continue to invest in plants and facilities as our customer demands grow.

We are in the process of developing our Sky Ranch property, including building finished lots for home builders and building the water and wastewater infrastructure for residential and commercial development of the property. In March 2018, we began construction of improvements for finished lots and will phase the construction of finished lots consistent with builder purchases of finished lots as defined in our agreements. 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 2019, we invested approximately \$17.7 million in our Sky Ranch property to deliver 255 finished lots and make other improvements to the remaining 251 lots.

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**

Colorado has experienced a robust housing market over the past 48 months. The key drivers to housing in the area are:

- **Housing Starts** – From September 2018 to September 2019, annual housing starts decreased by 9%. From September 2017 to September 2018, annual housing starts increased by 11.6%.
- **Unemployment** – The unemployment rate in Colorado was 2.2% at August 31, 2019, compared to a national unemployment rate of 3.5%.
- **Population** – The Denver Regional Council of Governments, 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 zoning 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 Rangeview 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.

### **Labor and Raw Materials**

We competitively bid contracts for infrastructure improvements (grading, utilities, roads, water and wastewater) at Sky Ranch. Contractors enter into fixed priced contracts where the contractor is at risk for cost overruns prior to completion of improvements. Under these fixed-price contracts, the contract prices are established in part based on fixed, firm subcontractor quotes on contracts and on cost and scheduling estimates. These quotes or estimates may be based on a number of assumptions, including assumptions about prices and availability of labor, equipment and materials, and other issues. Increased costs or shortages of skilled labor and/or concrete, steel, pipe and other materials could cause increases in property development costs and delays. These shortages and delays may result in delays in the delivery of the residential lots under development, reduced gross margins from lot sales, or both. While we contract with third parties for our labor and materials at a fixed price, which should allow us to mitigate the risks associated with increases in the cost of labor and building materials, other developments may arise which would increase lot delivery costs.

### **Competition**

#### ***Water and Wastewater Services***

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 entities' 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 Lowry Service Agreement, providing water and wastewater services to areas other than Wild Pointe, Sky Ranch and a portion 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 60,000 SFE units, and we believe that 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 that our pricing structure is competitive and that our water portfolio is well balanced among surface water rights, groundwater rights, storage capacity and reclaimed water supplies.



## ***Land Development***

Land development is a highly competitive business. There are numerous land developers, as well as properties and development projects, in the same geographic area in which Sky Ranch is located. Competition among land developers and development projects is determined by the location of the real estate, the market appeal of the development plan, and the developer's ability to build, market and deliver projects on a timely basis. Many of our land development competitors have greater financial resources than we do, and most if not all of our land development competitors have more development experience than we do. Residential developers sell to home builders, who in turn compete based on location, price, market segmentation, product design and reputation. Commercial, retail, and industrial developers sell to and/or compete with other developers, owners and operators of real estate.

## **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 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 (Code of Colorado Regulations 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. In 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 29 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 (the “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.

## 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.

### General Risks Related to Our Company

***Our operations are concentrated in the Front Range area of Colorado; we are subject to general economic conditions in Colorado.*** Our assets and operations are located solely in the Front Range area of Colorado. Our performance could be adversely affected by economic conditions in, and other factors relating to, Colorado, including supply and demand for housing, and zoning and other regulatory conditions. To the extent that the general economic conditions in the Front Range area of Colorado deteriorate, the value of our assets, our results of operations and our financial condition could be materially adversely affected.

***Our net losses may continue, and we may not have sufficient cash flows from operations or other capital resources to pursue our business objectives.*** While we have generated net income in the past two fiscal years, we have a long history of losses. Our cash flows from operations generally have not been sufficient to fund our operations, and we have been required to raise debt and equity capital and sell assets to remain in operation. Since 2004, we have raised \$76.3 million through (i) the issuance of \$25.3 million of common stock (including 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 continuing development of the first phase of Sky Ranch requires significant cash expenditures. We have advanced the CAB approximately \$20 million for construction of public improvements on the Sky Ranch property. The CAB is not required to repay us for advances made or expenses incurred for improvements at Sky Ranch unless and until the CAB and/or Sky Ranch Districts issue bonds in an amount sufficient to reimburse us for all or a portion of advances made or expenses incurred. We have funded and expect to continue to fund such expenditures with cash on hand and cash flows from operations. At August 31, 2019, we had approximately \$9.7 million of cash and marketable securities on hand, which is a significant decrease compared to our fiscal 2018 balance. We currently have a limited number of customers. If our cash on hand and future cash flows from operations are not sufficient to fund our operations and the significant capital expenditure requirements to build our water and wastewater systems and develop Sky Ranch, we may be forced to 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.

***We experience variability in our operating results on a quarterly basis and, as a result, our historical performance may not be a meaningful indicator of future results.*** We historically have experienced, and expect to continue to experience, variability in quarterly results. As a result of such variability, our short-term performance may not be a meaningful indicator of future results. Our quarterly results of operations may continue to fluctuate in the future as a result of a variety of factors, including, among others, the timing of the closings of sales of residential lots and weather-related problems.

***We have identified a material weaknesses in our internal control over financial reporting which could, if not remediated, result in material misstatements in our financial statements.*** Our management is responsible for establishing and maintaining adequate internal control over our financial reporting, as defined in Rule 13a-15(f) under the Exchange Act. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. As disclosed in Item 9A – Controls and Procedures, during the first quarter of fiscal 2020, we concluded that material weaknesses existed as of August 31, 2019. Specifically, management identified control deficiencies that constitute individually, or in the aggregate, material weaknesses in our internal control over financial reporting related to our expense accruals of costs incurred from related parties and preparation of our income tax provision. As of the date of this filing, we have not yet completed our remediation of these material weaknesses. We have, however, implemented compensating controls and are in the process of enhancing and revising the design of our existing controls and procedures to improve our identification of expense accruals of costs incurred from related parties and our preparation of income tax provisions. If our remedial measures are insufficient, or if additional material weaknesses or significant deficiencies in our internal controls are detected, we could be required to restate our financial results and/or experience a decline in the price of our common stock.

***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.

## Risks Related to Our Business Generally

***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 in part on housing developments being built near our water assets. The development of the Lowry Range, Sky Ranch and other properties is subject to many factors that are not within our control. If wholesale water sales are not forthcoming or development on the Lowry Range, Sky Ranch or other properties in our targeted service areas is delayed or curtailed, we may need to use our capital resources, incur additional short or long-term debt obligations or seek to sell additional equity. We may not have sufficient capital resources or be successful in obtaining additional operating capital. Although there have been positive market gains in the Colorado housing market in recent years, if a downturn in the homebuilding or credit markets returns, or if the state or national economy weakens and economic concerns intensify, such a development could have a significant negative impact on our business and financial condition and our plans for future development of additional phases of Sky Ranch.

Although the Colorado economy has become increasingly diverse, the oil and gas industry remains an important segment of the Colorado economy. New statutes, regulations or other initiatives that would limit oil and gas exploration or increase the cost of exploration, as well as declines in the price of oil and gas, among other things, could lead to a downturn in the Colorado economy, including increased unemployment, which would likely have a negative impact on the housing market and our business and financial condition.

***We may not be able to manage the increasing demands of our expanded operations.*** We have historically depended on a limited number of employees to administer our existing operations, interface with governmental bodies, market our services and plan for the construction and development of our assets. The execution of the Builder Contracts for Sky Ranch has increased the size and complexity of our business. The success of our current business and future business development and our 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. We may not be able to maximize the value of our assets if we are unable to attract and retain qualified personnel and to manage the demands of a workforce that has nearly tripled in the past two years. 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, claims for personal injury and property damage, and loss of contracts and revenues. We may be unsuccessful in managing our operations and growth.

***We are dependent on the services of a key employee.*** Our success largely depends on the continuing services of our President and Chief Financial Officer, Mark W. Harding. We believe that Mr. Harding possesses valuable knowledge, experience and leadership abilities that would be difficult in the short term to replicate. Mr. Harding also serves on the boards of the Rangeview District, the Sky Ranch Districts, and the CAB. The loss of Mr. Harding as a key employee and as a director of these boards would cause a significant interruption of our operations.

***Our construction of water and wastewater projects and improvements at Sky Ranch may expose us to certain completion, performance and financial risks.*** We expect to rely on independent contractors to construct our water and wastewater facilities and Sky Ranch lot improvements. These construction activities may involve risks, including shortages of materials and labor, work stoppages, labor relations disputes, injuries to third parties, damages to property, 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 and the construction and delivery of residential lots pursuant to our Builder Contracts. In addition, we may experience quality problems in the construction of our systems and facilities, including equipment failures. We may not meet the required deadlines under our Builder Contracts. We may face claims from customers or others regarding product quality and installation of equipment placed in service by contractors.

The Builder Contracts for Sky Ranch and contracts for the water and wastewater facilities that we design and construct are fixed-price contracts, in which we 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 quotes or 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.

Pursuant to our Builder Contracts for Sky Ranch, we guarantee project completion of water and wastewater delivery systems and lot improvements by a scheduled date. We also guarantee that the project, when completed, will achieve certain performance standards, meet certain quality specifications and satisfy certain requirements for governmental approvals. If we fail to complete the project as scheduled, meet guaranteed performance standards or quality specifications, or obtain the required governmental approvals, 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 and the quality specifications and to obtain the required government approvals. 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.

We are required to secure, or to have our subcontractors secure, performance and completion bonds for certain contracts and projects. The market environment for surety companies has become increasingly risk averse. We and our subcontractors secure performance and completion bonds for our contracts from these surety companies. To the extent we or our subcontractors are unable to obtain bonds, we may breach existing agreements and/or not be awarded new contracts. We may not be able to secure performance and completion bonds when required.

***Government regulations and legal challenges may delay the closing of the sale of our residential lots, increase our expenses or limit other activities, which could have a negative impact on our results of operations.*** The approval of numerous governmental authorities must be obtained in connection with both our water and wastewater projects and our land development activities, and these governmental authorities often have broad discretion in exercising their approval authority. We incur substantial costs related to compliance with legal and regulatory requirements. Any increase in legal and regulatory requirements may cause us to incur substantial additional costs. Various local, state and federal statutes, ordinances, rules and regulations concerning health and safety, site and building design, environmental, zoning, and similar matters apply to and/or affect the construction and operation of our water and wastewater systems and our land development activities. For example, zoning or other regulations may seek to limit housing density or create setbacks from oil and gas drilling operations or other restrictions on the use of land. To the extent that these regulations are modified, the value of the land that we already own or the availability of land that we are looking to acquire may decline, either of which may adversely impact the financial position, results of operations and cash flows of our business. In addition, our ability to obtain or renew permits or approvals and the continued effectiveness of permits already granted or approvals already obtained depends on factors beyond our control, such as changes in federal, state and local policies, rules and regulations and their interpretations and application. Furthermore, we are subject to various fees and charges of government authorities designed to defray the cost of providing certain governmental services and improvements. For example, local and state governments have broad discretion regarding the imposition of development fees for projects under their jurisdictions, as well as requiring concessions or that the property developer and/or home builder construct certain improvements to public places such as parks and streets or fund schools.

Municipalities or state water agencies may restrict or place moratoriums on the availability of utilities, such as water and sewer taps, which could have an adverse effect on our business by causing delays or increasing our costs.

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 Rangeview 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 Rangeview District uses to establish its rates and charges would increase to reflect these cost increases, thereby allowing the Rangeview District to increase its rates and charges. However, these water providers may not raise their rates in an amount that would be sufficient to enable the Rangeview District (and us) to cover any increased compliance costs.

In addition, there is a variety of legislation being enacted, or considered for enactment, at the federal, state and local level relating to energy and climate change. This legislation relates to items such as carbon dioxide emissions control and building codes that impose energy efficiency standards. Such environmental laws may affect, for example, how we manage storm water runoff, wastewater discharges and dust; how we develop or operate on properties on or affecting resources such as wetlands, endangered species, cultural resources, or areas subject to preservation laws; and how we address contamination. As climate change concerns continue to grow, compliance with legislation and regulations of this nature is expected to become more costly. Energy-related initiatives affect a wide variety of companies throughout the United States and the world and, because our operations are dependent on significant amounts of raw materials, such as pipe, steel and concrete, they could have an indirect adverse impact on our operations and profitability to the extent the manufacturers and suppliers of the materials used in the development of our properties are burdened with expensive tariffs, cap and trade and similar taxes and regulations. In addition, tariffs imposed by the United States on imported steel could increase our property development costs. 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 Rangeview 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 Rangeview District uses to establish its rates and charges to increase to cover increased compliance costs, such rates may not cover all our costs and our costs of complying with new standards or laws could adversely affect our business, results of operations or financial condition. Our noncompliance with environmental laws could result in fines and penalties, obligations to remediate, permit revocations and other sanctions.

Government agencies may initiate audits, reviews or investigations of our business practices to ensure compliance with applicable laws and regulations, which can cause us to incur costs or create other disruptions in our business that can be significant. Further, we may experience delays and increased expenses as a result of legal challenges to our proposed development activities, whether brought by governmental authorities or private parties.

***The enactment of Senate Bill 19-181 “Protect Public Welfare Oil and Gas Operations” increased the regulatory authority of local governments in Colorado over facilities siting and surface impacts of oil and gas development, which could have an adverse effect on our water sales to the oil and gas industry for hydraulic fracturing (“fracking”) and demand for new homes at Sky Ranch.*** Colorado Senate Bill 19-181 (“SB181”) was signed into law on April 16, 2019. Among other things, SB181 authorizes local governments to approve the siting of oil and gas locations and regulate the surface impacts of oil and natural gas development, including empowering local governments to adopt requirements that are more stringent than state requirements. SB181 changes the mission of the Colorado Oil and Gas Conservation Commission from fostering responsible and balanced development to regulating development to minimize adverse impacts to public health and the environment. SB181 also requires the Colorado Oil and Gas Conservation Commission and the Air Quality Control Commission to undertake rulemaking on numerous issues, including environmental protection, facility siting, application fees, and minimizing emissions of hydrocarbons and other compounds. Rulemaking activities by the State Commissions and local governments may result in new application and operating requirements that could lead to delays and additional costs for oil and gas operators, which, in turn, could result in a decline in oil and gas drilling activities. A significant decline in oil and gas drilling activities in and around the Lowry Range and our Sky Ranch property would have an adverse effect on our water sales for fracking and our financial condition. Further, a significant decline in oil and gas activities throughout Colorado could negatively impact the Colorado economy, which could have an adverse effect on demand for new homes at Sky Ranch.

***Natural disasters and severe weather conditions could delay the closing of the sale of residential lots at Sky Ranch and increase our costs, which could harm our sales and results of operations.*** We conduct our operations in the Colorado Front Range, which is subject to natural disasters, including droughts, tornadoes, wildland fires, and severe weather. The occurrence of natural disasters or severe weather conditions in Colorado or elsewhere could delay construction of our water and wastewater systems and/or property development, increase costs and lead to shortages of labor and materials. If our insurance or the insurance of our subcontractors does not fully cover business interruptions or losses resulting from these events, our results of operations could be adversely affected. For example, as a result of Hurricane Harvey in the Texas Gulf Coast in 2017, the cost of pipe used in our business increased approximately 35%. This additional cost is not clearly reimbursable by insurance.

***We may be subject to significant potential liabilities as a result of warranty and liability claims made against us.*** Design, construction or system failures related to our water and wastewater delivery systems could result in injury to third parties or damage to property. In addition, as a property developer, we are subject in the ordinary course of our business to warranty claims. We are also subject to claims for losses or injuries that occur in the course of our property development activities. We plan to record warranty and other reserves for the residential lots we sell based on historical trends in our market and our judgment of the qualitative risks associated with the type of lots we sell. We have, and many of our subcontractors have, general liability, property, workers’ compensation and other business insurance. These insurance policies are intended to protect us against a portion of our risk of loss from claims, subject to certain self-insured retentions, deductibles and coverage limits. However, it is possible that this insurance will not be adequate to address all warranty and liability claims to which we are subject. Additionally, the coverage offered and the availability of general liability insurance for construction defects are currently limited and policies that can be obtained are costly and often include exclusions based upon past losses insurers suffered as a result of use of defective materials used by other property developers. As a result, our subcontractors may be unable to obtain insurance, and we may have to waive our customary insurance requirements, which increases our and our insurers’ exposure to claims and increases the possibility that our insurance will not be adequate to protect us for all the costs we incur. 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. No warranty and liability claims have been made against us as of the date of this report.

***A major health and safety incident relating to our business could be costly in terms of potential liabilities and reputational damage.*** Water facility and land development construction sites are inherently dangerous and pose certain inherent health and safety risks to construction workers and other persons on the site. Any failure in health and safety performance may result in penalties for non-compliance with relevant regulatory requirements, and a failure that results in a major or significant health and safety incident is likely to be costly in terms of potential liabilities incurred as a result. Such a failure could generate significant negative publicity and have a corresponding impact on our reputation, our relationships with relevant regulatory agencies or governmental authorities, and our ability to attract customers and employees, which in turn could have a material adverse effect on our business, financial condition and operating results.

***Conflicts of interest may arise relating to the operation of the Rangeview District, the Sky Ranch Districts and the CAB.*** Our President and Chief Financial Officer and two of our employees constitute 75% of the directors of each of the Rangeview District, the Sky Ranch Districts and the CAB. Pure Cycle, along with its officers and employees and two unrelated individuals, own certain property interests in the 40 acres that constitute the Rangeview District and the acreage that constitutes the Sky Ranch Districts. We have made loans to the Rangeview District to fund its operations. At August 31, 2019, total principal and interest owed to us by the Rangeview District was \$961,300. Pursuant to our water and wastewater service agreements with the Rangeview District, the Rangeview District retains two percent of the revenues from the sale of water to its end-use customers and 10% of the revenues from the provision of wastewater services to its end-use customers. Proceeds from the fee collections will initially be used to repay the Rangeview District’s obligations to us, but after these loans are repaid, the Rangeview 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 Districts, which amounts were fully refunded to the Company as of August 31, 2019, and we have advanced the CAB approximately \$20 million for construction of public improvements on the Sky Ranch property. The CAB is not required to repay us for advances made or expenses incurred for improvements at Sky Ranch unless and until the CAB and/or Sky Ranch Districts issue bonds in an amount sufficient to reimburse us for all or a portion of advances made or expenses incurred. We have received benefits from our activities undertaken in conjunction with the Rangeview and Sky Ranch Districts and the CAB, but conflicts may arise between our interests and those of the Rangeview and Sky Ranch Districts and the CAB and our officers and employees who are acting in dual capacities in negotiating contracts to which we and a district and/or the CAB are parties. We expect that the Rangeview and Sky Ranch 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 obligations to those other constituents. Conflicts may not 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 these districts. Our officers and employees may not remain as directors of these districts, and the actions of subsequently elected boards could have an adverse impact on our operations.

***Growth limitations or moratoriums imposed by governmental authorities could adversely affect our land development activities or the land development activities of our customers, which could adversely impact both the land development and water and wastewater segments of our business.*** The State of Colorado or counties in which our service areas and properties are located may approve limitations or moratoriums on residential growth within their respective boundaries, which limitations or moratoriums could have the effect of delaying, limiting or halting development within Sky Ranch or other areas where we may provide water and wastewater services or develop land. We are not aware of any such proposals in the areas in which we operate, but proposals have been made to limit growth in various communities along the Front Range. Because all of the property in Sky Ranch has been platted, we do not expect future growth moratoriums to restrict Sky Ranch as currently planned; however, if growth moratoriums or restrictions are imposed in the areas in which we provide services or develop land, it could negatively impact our ability to develop our land as planned or our customers' ability to grow their communities as anticipated, which would also reduce the number of water and wastewater service customers we expect, which would have a negative impact on our business and financial condition.

***We could be hurt by efforts to impose liabilities or obligations on persons with regard to labor law violations by other persons whose employees perform contracted services.*** The infrastructure and improvements on our water and wastewater systems and on the finished lots we sell or that we must provide pursuant to service agreements and lot development agreements are done by employees of subcontractors and other contract parties. We do not have the ability to control what these contract parties pay their employees or the work rules they impose on their employees. However, there have been efforts by government agencies to hold contract parties like us responsible for violations of wage and hour laws and other work-related laws by firms whose employees are performing contracted-for services. A 2016 National Labor Relations Board ("NLRB") ruling held that for labor law purposes a firm could under some circumstances be responsible as a joint employer of its contractors' employees even if the firm had no direct control over the employees' terms and conditions of employment. That ruling was largely affirmed by the U.S. Court of Appeals for the D.C. Circuit, which clarified that only indirect control that affects the essential terms and conditions of employment could be considered. However, in September 2018, the NLRB proposed an even narrower rule governing joint employment, which is that an employer may be found to be a joint employer of another employee's employees only if it possesses and exercises substantial, direct and immediate control over the essential terms and conditions of employment and has done so in a manner that is not limited and routine. Indirect influence and contractual reservations of authority would not be sufficient to establish a joint employer relationship. This proposed rule has received public comment but is still under consideration by the NLRB. It is unclear whether it will be implemented and whether a court would apply it retroactively, but it could effectively overrule most or all of the 2016 NLRB case and subsequent appellate decision. Governmental rulings that make us responsible for labor practices by our subcontractors could create substantial exposures for us in situations that are not within our control.

***Unauthorized access to confidential information and data on our information technology systems and security and data breaches could materially adversely affect our business, financial condition and operating results.*** As part of our operations, we rely on our computer systems to process transactions, communicate with our suppliers and other third parties, and on continued and unimpeded access to secure network connections to use our computer systems. We have physical, technical and procedural safeguards in place that are designed to protect information and protect against security and data breaches as well as fraudulent transactions and other activities. Despite these safeguards and our other security processes and protections, we cannot be assured that all of our systems and processes are free from vulnerability to security breaches (through cyberattacks, which are evolving and becoming increasingly sophisticated, physical breach or other means) or inadvertent data disclosure by third parties or by us. A significant data security breach, including misappropriation of customer, supplier or employee confidential information, could cause us to incur significant costs, which may include potential costs of investigations, legal, forensic and consulting fees and expenses, costs and diversion of management attention required for investigation, remediation and litigation, substantial repair or replacement costs. We could also experience data losses that would impair our ability to manage our business operations, including accounting and project costs, manage our water and wastewater systems or process transactions and have a negative impact on our reputation and loss of confidence of our customers, suppliers and others, any of which could have a material adverse impact on our business, financial condition and operating results.

## **Risks Related to the Water Segment of Our Business**

***The rates that the Rangeview District is allowed to charge customers on the Lowry Range for water services are limited by the Lease with the Land Board and our contract with the Rangeview District and may not be sufficient to cover our costs of construction and operation.*** The prices charged by the Rangeview 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 Rangeview District surveys the tap fees and rates of the three nearby providers, and the Rangeview 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. We receive 100% of tap fees and 98% of water usage fees charged by the Rangeview District to its customers after the deduction of royalties owed to the Land Board. Our costs associated with the construction of water 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 Rangeview 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. Both increased customer demand and 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 water service to the Rangeview District for use at the Lowry Range at a loss. The Rangeview 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 water 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.

***Our water sales for the past two years have been highly concentrated among companies providing fracking services to the oil and gas industry, and such sales can fluctuate significantly.*** Our water sales have been historically highly concentrated directly and indirectly with one to three companies providing fracking services to the oil and gas industry on and around the Lowry Range and our Sky Ranch property. Generally, investment in oil and gas development is dependent on the price of oil and gas. While water sales for fracking represented 90% and 89% of our total water revenues during the fiscal years ended August 31, 2019 and 2018, respectively, we have no long-term contractual commitments that will ensure these sales in the future. The oil and gas industry has periodically gone through periods when activity has significantly declined. For example, water sales for fracking represented less than 1% of our total water revenues during the fiscal year ended August 31, 2016.

Further sales to this customer base as well as renewals of our oil and gas leases, if any, in the future are impacted by statutory ballot initiatives, regulations, court interpretations of the statutory mandate of the Colorado Oil and Gas Conservation Commission, fracking technologies, the success of the wells and the price of oil and gas, among other things. For example, certain interest groups in Colorado opposed to oil and natural gas development generally, and hydraulic fracturing in particular, advanced a ballot initiative that would have resulted in oil and natural gas development in the state being significantly curtailed. The initiative was not approved by the voters of Colorado in the November 2018 election. The Colorado Oil and Gas Conservation Commission estimated that implementation of the proposed initiative would have made drilling unlawful on approximately 85% of the non-federal surface area of the state of Colorado. Although this initiative did not pass, interest groups opposed to oil and natural gas development have continued to seek restrictions. The enactment of SB181 and the release of a Colorado Department of Public Health and Environment report dated October 17, 2019, entitled Final Report: Human Health Risk Assessment for Oil & Gas Operations in Colorado, concluding that people living within 2,000 feet of fracking sites could face elevated health risks may lead to increased opposition and tougher oversight of oil and gas operations, which could reduce the demand for water for fracking.

***A significant portion of our water supplies come from non-renewable aquifers.*** A significant portion of our water supplies comes from non-renewable Denver Basin aquifers. The State of Colorado regulates development and withdrawal of water from the Denver Basin aquifers to a rate of 1 percent of the aggregate amount of water determined to be in storage each year, which means our supply should last approximately 100 years even if no efforts were made to conserve or recharge the supply. Nonetheless, we may need to seek additional water supplies as our non-renewable supplies are depleted. While the acquisition of Lost Creek water, a renewable "surface" water right that is diverted from an alluvial aquifer that is hydrologically connect to the surface water system, mitigates some of the risk of owning non-renewable supplies, if we are unable to obtain sufficient replacement supplies, it would have a material adverse impact



on our business and financial condition. Additionally, the cost of developing and withdrawing water from the aquifers will increase over time, and we may not be able to recover the increased costs through our rates and charges. Increased costs to develop water from the aquifers could have a significant negative impact on our business, results of operations, cash flows and financial condition.

***A failure of the water wells or distribution networks that we own or control could result in losses and damages that may affect our business and financial condition.*** We distribute water through a network of pipelines and store water in storage tanks and ponds. A failure of these pipelines, tanks or ponds 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 ponds 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 business, results of operations, cash flows, and financial condition. 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.

***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 losses associated with or the costs of these claims.

***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 that we are a public utility under Colorado law. We currently provide services by contract mainly to the Rangeview District, which supplies the public. Quasi-municipal metropolitan districts, such as the Rangeview District and the Sky Ranch Districts, 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 Rangeview District’s and our rights under the Lease have been challenged by third parties.*** The Rangeview 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 Rangeview District against the Land Board, the Land Board, the Rangeview District and we amended and restated the Lease to clarify and update a number of provisions. However, there are issues still subject to disagreement and negotiation, including our rights with respect to revenue from our Export Water after 2081, and it is likely that during the remaining term (through 2081) of the Lease, the parties will disagree over interpretations of provisions in the Lease again. The Rangeview District’s or our rights under the Lease could be challenged in the future, which could require potentially expensive litigation to enforce our rights.

***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 each of fiscal 2012 and 2018, the Lowry Range conditional decrees were granted review by the water court, which determined that we and the Rangeview District met the diligence criteria. The water court entered a finding of reasonable diligence on the Lowry Range surface water decrees in January 2019. Our next review for reasonable diligence on the Lowry Range surface water decrees will be in January 2025. We believe that we will be successful in maintaining our decrees as we continue to develop these rights. If the water court does not make a determination of reasonable diligence, the value of our interests in the Rangeview Water Supply would be materially adversely impacted.

***Our operations are affected by local politics and governmental procedures that 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 Rangeview District in regional cooperative resource programs, such as the SMWSA and the WISE partnership with Denver Water and Aurora Water, as well as education and communication efforts and community involvement, our efforts may be unsuccessful.

***The number of connections we can serve are affected by local governmental policies that are beyond our control.*** We market our water rights through service agreements to developers, municipalities and other governmental entities run by elected or politically appointed officials. We believe that our water rights can serve approximately 60,000 single family connections based on standards applied to water providers in Arapahoe, Douglas, and Adams Counties. These standards are policy driven, based on assumed life and reliability of water supplies and may become more restrictive at the discretion of the governmental entity. If these standards become more restrictive, water supplies of all water providers, including those of the Company, may not serve the number of connections that providers currently estimate.

***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. We may not 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 30 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.

## **Risks Related to the Land Development Segment of Our Business**

***The homebuilding industry is cyclical and a deterioration in industry conditions or downward changes in general economic or other business conditions could adversely affect our business, results of operations, cash flows and financial condition.*** The residential homebuilding industry is cyclical and is highly sensitive to changes in general economic conditions such as levels of employment, consumer confidence and income, availability of mortgage financing for acquisitions, interest rate levels and inflation, among other factors. Beginning in 2006 and continuing through 2012, the U.S. and Colorado housing markets were unfavorably impacted by a severe weakness in new home sales attributable to, among other factors, weak consumer confidence, tightened mortgage standards, large supplies of foreclosure, resale and new homes and a more challenging appraisal environment. These conditions, combined with a prolonged economic downturn, high unemployment levels, increases in the rate of inflation and uncertainty in the U.S. economy, contributed to a decreased demand for housing, declining sales prices and increased pricing pressure. Additionally, the residential housing market is impacted by federal and state personal income tax rates and provisions, and government actions, policies, programs and regulations directed at or affecting the housing market, including the Tax Cuts and Jobs Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act, tax benefits associated with purchasing and owning a home, and the standards, fees and size limits applicable to the purchase or insuring of mortgage loans by government-sponsored enterprises and government agencies. In fiscal 2019, housing starts in Colorado declined compared to housing starts in fiscal 2018. Although the number of housing starts continues to be

better than during the last economic downturn, if the recovery of the Colorado housing market reverses, we could experience declines in the market value of our inventory and demand for our lots, which could have a material adverse effect on our business, results of operations, cash flows and financial condition.

***We have limited experience with the development of real property.*** While we have extensive experience designing and constructing water and wastewater facilities and maintaining and operating these facilities, we have limited experience developing real property. We may underestimate the capital expenditures required to develop Sky Ranch, including the costs of certain infrastructure improvements. We also have limited experience in managing property development activities, including the permitting and other approvals required, which may result in delays in obtaining the necessary permits and government approvals.

***Significant competition from other development projects could adversely affect our results.*** Land development is a highly competitive business. There are numerous land developers, as well as properties and development projects, in the same geographic area in which Sky Ranch is located. Many of our land development competitors may have advantages over us, such as more favorable locations, which may provide more desirable schools and easier access to roads and shopping, or amenities that we may not offer, as well as greater financial resources. If other development projects are found to be more attractive to homebuyers, home builders or other developers or operators of real estate based on location, price, or other factors, then we may be pressured to reduce our prices or delay further development, either of which could materially adversely affect our business, results of operations, cash flows and financial condition.

***The funds that we are advancing to the CAB for construction of public improvements might not be repaid, which would negatively impact our results of operations, cash flows and financial condition.*** We have advanced the CAB approximately \$20 million for construction of public improvements and expect to fund an additional estimated \$8.4 million in buildout costs that we expect will be reimbursable by the CAB. The ability and obligation of the CAB to reimburse us is dependent on sufficient home sales and commercial development occurring at Sky Ranch to create a tax base that would enable the CAB to issue bonds to pay for the improvements. If development at Sky Ranch is delayed or curtailed for any reason, including regulatory restrictions, a downturn in the economy or default by one or more of the builders at Sky Ranch, the CAB may not have sufficient revenues to issue bonds. Failure of the CAB to repay a significant portion of the funds that we have advanced would negatively impact our business, results of operations, cash flows and financial condition.

***Supply shortages and risks related to the demand for skilled labor and building materials could increase costs and delay closings.*** The property development industry is highly competitive for skilled labor and materials. Labor shortages in the Colorado Front Range have become more acute in recent years as the supply chain adjusts to uneven industry growth. Increased costs or shortages of skilled labor and/or concrete, steel, pipe and other materials could cause increases in property development costs and delays. We are unable to pass on increases in property development costs to home builders with whom we have already entered into purchase and sale contracts for residential lots, as our contracts fix the price of the lots at the time the contracts are signed, which will be well in advance of property development. Sustained increases in development costs may, over time, erode our margins.

***Products supplied to us and work done by subcontractors can expose us to risks that could adversely affect our business.*** We rely on subcontractors to perform the actual property development, and in many cases, to select and obtain concrete and other materials. Subcontractors may use improper construction processes or defective materials. Defective products can result in the need to perform extensive repairs. The cost of complying with our warranty obligations may be significant if we are unable to recover the cost of repairs from subcontractors, materials suppliers and insurers.

***We may purchase additional land parcels for development or other purposes, thereby exposing us to certain financial risks.*** In the future, we may purchase additional land parcels for development or other purposes. As noted above, land development requires significant cash expenditures before positive cash flows can be generated from the sale of lots and water and sewer tap fees. If there is considerable lag time between the time we acquire land and the time we begin selling finished lots, we may generate significant operating losses. In addition, if sales of homes on the finished lots are delayed, our revenue from utility services will be delayed. If our cash on hand and future cash flows from operations are not sufficient to fund our operations and the significant capital expenditure requirements to develop any acquired land and build water and wastewater systems, we may be forced to seek to obtain additional debt or equity capital. There can be no assurance that financing will be available on acceptable terms or at all.

***Delays in property development may extend the time it takes us to recover our property development costs.*** We incur many costs, such as the costs of preparing land, finishing and entitling lots, installing roads, sewers, water systems and other utilities, taxes and other costs related to ownership of the land, before we close on the sale of residential lots to home builders. If the rate at which we develop residential lots slows, we may incur additional costs, and it may take longer for us to recover our costs. In addition, if sales of homes on the finished lots are delayed, our revenue from utility services will be delayed.

***Fluctuations in real property values may require us to write-down the book value of our land interests.*** The land development industry is subject to significant variability and fluctuations in real property values. As a result, the Company may be required to write-down the book value of its Sky Ranch or other land interests in accordance with accounting principles generally accepted in the United States of America, and some of those write-downs could be material. Any material write-downs of assets could have a material adverse effect on our business, prospects, financial condition or results of operations. The Company assesses its land interests when indicators of

impairment exist. Indicators of impairment include a decrease in demand for housing due to soft market conditions; competitive pricing pressures that reduce the average sales price of finished lots; sales absorption rates below management expectations; a decrease in the value of homes or the underlying land due to general market conditions, actual or perceived risks due to proximity to oil and gas drilling operations, or other reasons; and a decrease in projected cash flows for a project.

***Our land development segment may be subject to risks related to oil and gas operations in the vicinity of our Sky Ranch development, which could have an adverse impact on the marketability and/or value of our Sky Ranch property.*** We have leased the minerals underlying Sky Ranch to a wholly owned subsidiary of a major independent exploration and production company. Oil and gas extraction is an inherently dangerous activity that can potentially lead to air and water contamination, fire, explosion or other hazards. While the State of Colorado, local governments, and private operators have regulations and procedures in place intended to mitigate these risks, there can be no assurances that these safeguards will be effective in all cases with respect to any oil and gas activity around Sky Ranch. The existence of oil and gas wells and drilling activity in or near our property and public concern regarding the negative health impacts from emissions near drilling and hydraulic fracturing sites, including those detailed in a recent 380-page report submitted to the Colorado Department of Public Health and Environment entitled the *Final Report: Human Health Risk Assessment for Oil & Gas Operations in Colorado* dated October 17, 2019, may adversely impact the marketability and/or value of the lots at Sky Ranch and decrease demand for homes in proximity to oil and gas operations, negatively impacting our land development segment, which could also negatively impact our business and financial condition.

## **Item 1B – Unresolved Staff Comments**

None.

## **Item 2 – Properties**

### **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 own or have exclusive use rights to a 500,000-gallon water tank, a 1,000,000-barrel storage reservoir, a 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. Although owned by the Rangeview District, we have exclusive rights to use, operate and maintain another 500,000-gallon water tank, two deep water wells, a pump station, three alluvial wells, two wastewater treatment plants, and water distribution and wastewater collection pipelines that serve customers located at the Lowry Range and Sky Ranch. Although owned by the Elbert 86 District, we have exclusive rights to use, operate and maintain two water tanks with a combined capacity of 438,000 gallons of water, two deep water wells, a pump station, and 10 miles of transmission line for the Wild Pointe development in Elbert County. These assets are used to provide service to our customers.

### **Land and Mineral Interests**

We own approximately 780 acres of land (together with 634 net mineral acres), which are part of a development known as Sky Ranch that is described further in *Item 1 – Our Water and Land Assets – Sky Ranch*. We own 40 acres of land that comprise the current boundaries of the Rangeview District (together with all the minerals). We also own approximately 700 acres of land (together with all the minerals) in the Arkansas River Valley. In addition, we hold approximately 13,900 acres of mineral interests (inclusive of our 700 acres in the Arkansas River Valley) in Southeast Colorado in Otero, Bent and Prowers Counties.

## **Item 3 – Legal Proceedings**

None.

## **Item 4 – Mine Safety Disclosures**

None.

## 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 Stock Market under the symbol “PCYO.”

#### Holders

On November 7, 2019, there were 740 holders of record of our common stock.

#### Dividends

We have never paid any dividends on our common stock and expect for the foreseeable future to retain all of our capital and earnings from operations, if any, for use in expanding and developing our business. Any future decision as to the payment of dividends will be at the discretion of our board of directors and will depend upon our earnings, financial position, capital requirements, plans for expansion and such other factors as our board of directors deems relevant. The terms of our Series B Preferred Stock prohibit payment of dividends on common stock unless all dividends accrued on the Series B Preferred Stock have been paid and require dividends to be paid on the Series B Preferred Stock if proceeds from the sale of Export Water exceed \$36,026,232. For further discussion, see Note 8 – *Shareholders’ Equity* to the accompanying financial statements.

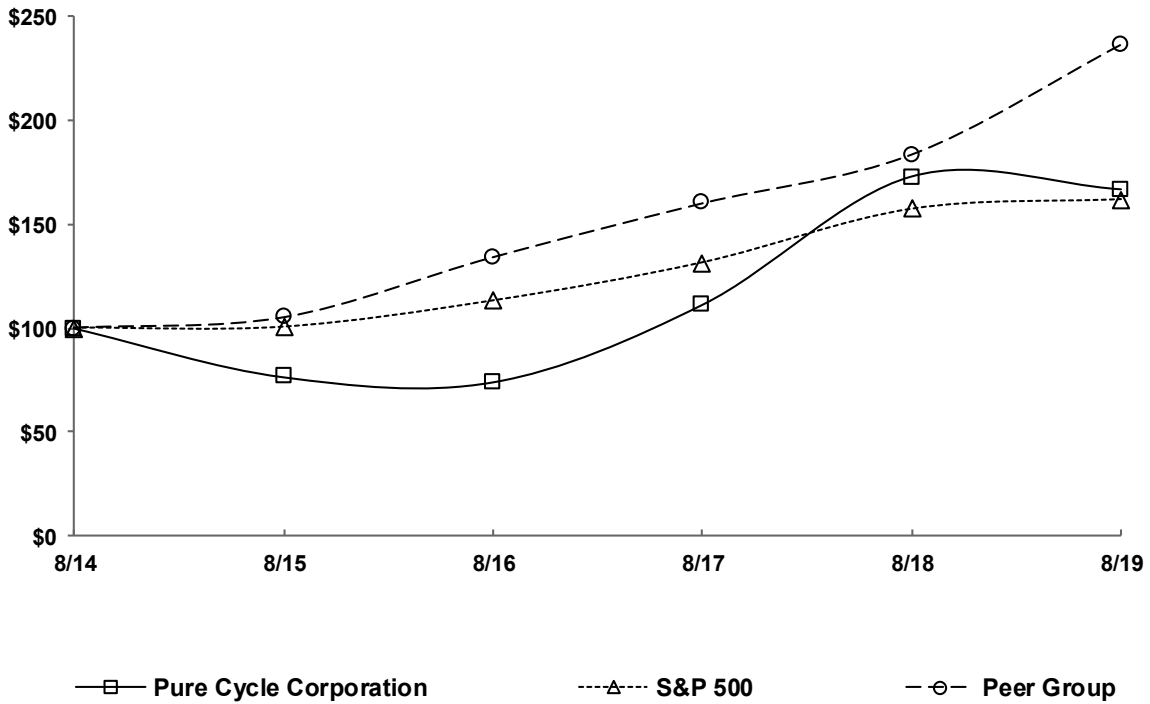
#### Performance Graph (1)

The graph below compares the cumulative total return of our common stock for the last five fiscal years with the cumulative total return for the same period of the S&P 500 Index and a peer group index <sup>(2)</sup>. The graph assumes the investment of \$100 in common stock in each of the noted indices as of the market close on August 31 and reinvestment of all dividends.

	<u>August 2014</u>	<u>August 2015</u>	<u>August 2016</u>	<u>August 2017</u>	<u>August 2018</u>	<u>August 2019</u>
Pure Cycle Corporation	\$ 100.00	\$ 76.69	\$ 74.23	\$ 111.20	\$ 172.55	\$ 166.41
S&P 500	\$ 100.00	\$ 100.48	\$ 113.09	\$ 131.45	\$ 157.30	\$ 161.89
Peer Group (2)	\$ 100.00	\$ 105.04	\$ 134.01	\$ 160.01	\$ 183.55	\$ 236.60

## COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\*

Among Pure Cycle Corporation, the S&P 500 Index,  
and Peer Group



\*\$100 invested on 8/31/14 in stock or index, including reinvestment of dividends.  
Fiscal year ending August 31.

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- (1) This performance graph is not “soliciting material,” is not deemed “filed” with the SEC and is not to be incorporated by reference in any of our filings under the Securities Act or the Exchange Act whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.
- (2) The peer group consists of the following companies that have been selected on the basis of industry focus and size: American States Water Company, Aqua America, Inc., Artesian Resources Corp., California Water Service Group, Connecticut Water Service, Inc., Middlesex Water Company, SJW Corp., and The York Water Company.

### Recent Sales of Unregistered Securities; Use of Proceeds from Registered Securities

None.

### Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

## Item 6 – Selected Financial Data

### Table D – Selected Financial Data

In thousands (except per share data)

	For the Fiscal Years Ended August 31,				
	2019	2018	2017	2016	2015
Summary Statement of Operations Items:					
Total revenue	\$ 20,361.5	\$ 6,959.2	\$ 1,227.8	\$ 452.2	\$ 1,196.6
Income (loss) from operations	\$ 3,528.0	\$ 132.7	\$ (1,678.8)	\$ (1,230.3)	\$ (575.1)
Net income (loss)	\$ 4,811.1	\$ 414.7	\$ (1,710.9)	\$ (1,310.6)	\$ (23,127.9)
Basic and diluted income (loss) per share	\$ 0.20	\$ 0.02	\$ (0.07)	\$ (0.06)	\$ (0.96)
Weighted average diluted shares outstanding	24,003	23,930	23,754	23,781	24,041
	As of August 31,				
	2019	2018	2017	2016	2015
Summary Balance Sheet Information:					
Current assets	\$ 23,537.7	\$ 27,918.2	\$ 27,124.3	\$ 29,085.9	\$ 39,580.9
Total assets	\$ 83,721.4	\$ 71,906.6	\$ 69,787.6	\$ 70,879.6	\$ 73,060.9
Current liabilities	\$ 8,297.2	\$ 2,054.0	\$ 940.2	\$ 482.2	\$ 1,499.1
Long-term liabilities	\$ 693.0	\$ 399.4	\$ 1,341.3	\$ 1,399.5	\$ 1,476.4
Total liabilities	\$ 8,990.3	\$ 2,453.4	\$ 2,281.5	\$ 1,881.7	\$ 2,975.5
Shareholders' equity	\$ 74,731.1	\$ 69,453.2	\$ 67,506.1	\$ 68,997.9	\$ 70,085.4

The following items had a significant impact on our operations:

- In fiscal 2019, due to land development activities at Sky Ranch, we recognized \$12.0 million in revenue from lot sales and \$3.4 million in revenue from the sale of water and wastewater taps. Our revenue from water sales increased by 2% to \$4.7 million primarily related to industrial water sales. We invested \$14.1 million in our water and wastewater systems, including \$8.1 million for the wastewater facility at Sky Ranch and \$3.5 million for a water right and land acquisition, \$354,000 for the purchase of equipment and \$17.7 million in *Inventories* for the development of our Sky Ranch property. During fiscal 2019, we had net sales or maturities of marketable securities of approximately \$3.7 million. In addition, we released our valuation allowance on our net deferred tax assets and recognized a deferred tax benefit of \$1,284,100.
- In fiscal 2018, we invested \$1.1 million in our water and wastewater systems, \$1.8 million for the construction of pipelines, \$5.3 million for the development of our Sky Ranch property, and \$445,400 for the purchase of equipment. During fiscal 2019, we had net sales or maturities of marketable securities of approximately \$11.4 million. Our revenue from water sales increased by 452% to \$4.6 million primarily related to industrial water sales. In addition, we began construction on Sky Ranch and recognized \$2.1 million in revenue from platted lot sales.
- In fiscal 2017, we invested \$2.5 million in our water and wastewater systems, \$4.4 million for the construction of pipelines, \$902,600 for the development of our Sky Ranch property, and \$95,400 for the purchase of equipment. During fiscal 2017, we had sales or maturities of marketable securities of approximately \$9.8 million.
- In fiscal 2016, we invested \$923,800 in our water and wastewater systems and \$285,600 for planning and design of our Sky Ranch property. We also purchased three farms for approximately \$450,300 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.
- In fiscal 2015, we sold our remaining farm assets for approximately \$45.8 million, for a loss of approximately \$22.3 million. In conjunction with the sale, we repaid \$4.9 million in mortgage debt relating to the farms and we invested approximately \$3.5 million into our water systems. Financial results for the farm assets have been reflected as discontinued operations, and all prior periods have been reclassified.



## Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations

### Overview

*The discussion and analysis below includes certain forward-looking statements that are subject to risks, uncertainties and other factors, as described in “Risk Factors” and elsewhere in this Annual Report on Form 10-K, that could cause our actual growth, results of operations, performance, financial position and business prospects and opportunities for this fiscal year and the periods that follow to differ materially from those expressed in, or implied by, those forward-looking statements. Readers are cautioned that forward-looking statements contained in this Annual Report on Form 10-K should be read in conjunction with our disclosure under the heading “FORWARD-LOOKING STATEMENTS” on page 1.*

The following Management’s Discussion and Analysis (“MD&A”) is intended to help the reader understand the results of operations and our financial condition and should be read in conjunction with the accompanying financial statements and the notes thereto included in *Part II, Item 8* of this Annual Report on Form 10-K. The following sections focus on the key indicators reviewed by management in evaluating our financial condition and operating performance, including the following:

- Revenue generated from providing water and wastewater services;
- Expenses associated with developing our water and land assets;
- Revenue from lot sales at Sky Ranch;
- Expenses associated with developing lots at Sky Ranch; and
- Cash available to continue development of our land, water rights and service agreements.

Our MD&A section includes the following items:

Executive Summary – a summary of important financial metrics in fiscal 2019.

Our Business – a general description of our business, our services and our business strategy.

Critical Accounting Policies and Use of Estimates – a discussion of our critical accounting policies that require critical judgments, assumptions and estimates.

Results of Operations – an analysis of our results of operations for the three fiscal years presented in our financial statements. We present our discussion in the MD&A in conjunction with the accompanying financial statements.

Liquidity, Capital Resources and Financial Position – an analysis of our cash position and cash flows, as well as a discussion of our financial obligations.

### Executive Summary

Fiscal 2019 included the following notable items:

- Total revenue increased by \$13.4 million or 193% versus fiscal 2018 to \$20.4 million due primarily to lot sales and water and wastewater tap fees
- Net income increased by \$4.4 million or 1,060% versus fiscal 2018 to \$4.8 million.
- Fully diluted earnings per common share for fiscal 2019 was \$0.20 versus \$0.02 for fiscal 2018.

In fiscal 2019, our revenue totaled \$20.4 million primarily related to the closing of sales of 255 lots and 113 water and wastewater taps to our three home builder customers. We recognized \$12 million in revenue from lot sales and \$3.5 million in revenue from the sale of water and wastewater taps, compared to \$2.2 million and \$50,000, respectively, during fiscal 2018. As a result of the strong performance of our land development segment and the net tax benefit due to releasing our valuation allowance on our net deferred tax asset in 2019, net income increased to \$4.8 million in fiscal 2019 compared to \$414,700 in fiscal 2018 or an increase of 1,060%. Please see below for further discussion of our results.

### Our Business

Pure Cycle Corporation is a Colorado corporation that operates in two business segments. We develop wholesale water and wastewater systems in the water-short Denver metropolitan area and are developing a Master Planned Community on approximately 930 acres of land located along the Interstate 70 corridor (“I-70”), approximately four miles south of Denver International Airport (“DIA”). The Company has accumulated valuable water and land interests over the past 30 years and has developed an extensive network of wholesale water production, storage, treatment, and distribution systems, and wastewater collection and treatment systems which serve domestic, commercial and industrial customers in the Denver metropolitan region. Our land assets are located in one of the most active development areas in the Denver metropolitan region along I-70.

Our operations are focused in two business segments: (i) providing wholesale water and wastewater services, and (ii) land development activities in which we serve as the Master Plan developer for approximately 930 acres of land known as Sky Ranch. The master plan includes a mix of 3,200 single-family and multifamily residential units and over 2 million square feet of commercial, retail, and industrial space.

## **Water and Wastewater Utilities**

Water resources throughout the western United States and more prominently in Colorado are a scarce and valuable resource. Our Company owns or controls a portfolio of approximately 29,200 acre feet of groundwater and surface water supplies, approximately 26,000 acre feet of adjudicated reservoir sites, two wastewater reclamation facilities, water treatment facilities, potable and raw water storage facilities, wells and water production facilities, and nearly 50 miles of water distribution and wastewater collection lines. Our water supplies and wholesale facilities are located in southeast Denver, in Arapahoe County, an area which is limited in both water availability and infrastructure to produce, treat, store, and distribute water and wastewater, which we believe provides us with a unique competitive advantage offering these services.

We provide wholesale water and wastewater service to local governments, including the Rangeview District, Arapahoe County, the CAB, and Elbert 86 District. Our mission is to provide reliable, high quality water to our customers and collect and treat wastewater using advanced water treatment systems, which produce high quality reclaimed water we can reuse for outdoor irrigation and industrial demands. By using and reusing our water supplies, we seek to demonstrate good stewardship over our valuable water rights in the water-scarce Denver, Colorado region. We design, permit, construct, operate and maintain wholesale water and wastewater systems that we own or operate on behalf of governmental entities. We also design, permit, construct, operate and maintain retail distribution and collection systems that we own or operate on behalf of our governmental customers. Additionally, we handle administrative functions, including meter reading, billing and collection of monthly water and wastewater revenues, regulatory water quality monitoring, sampling, testing, and reporting requirements to the Colorado Department of Public Health and Environment.

Our utility segment generates revenues from three sources: (i) tap fees, which are a one-time charge to home builders or businesses to connect to our water and wastewater systems, (ii) usage charges, which are monthly metered water and wastewater fees, and (iii) construction or special facility fees, which are specifically contracted for when necessary. We estimate that our water portfolio can provide service to approximately 60,000 single family connections (“SFEs”). Our current water tap fee is \$26,675 per SFE, and our wastewater tap fee is \$4,659 per SFE. On average, we generate annual revenue of approximately \$1,000 per SFE water connection and \$500 per SFE wastewater connection. We provide potable water to nearly 460 SFE connections and domestic wastewater services to approximately 210 SFEs.

### *Industrial Frack Water Deliveries*

In addition to our domestic customers, we provide raw water to industrial customers in the oil and gas industry for hydraulic fracturing. Both our potable water and industrial water customers are located in southeastern Denver, where competing water supplies and water systems are limited, well positioning us to deliver these valuable services to our customers. Growth in the Denver area has trended east with significant activity occurring along the I-70 corridor, which enjoys excellent transportation infrastructure with I-70, rail access, and DIA. The region has significant employment centers, including DIA, the University of Colorado Anschutz Medical Campus, an Amazon fulfillment center, the Rocky Mountain Regional VA Medical Center, and more, creating demand for residential, retail, and commercial development opportunities. The region has experienced significant oil and gas activity over the past seven years with multiple operators leasing more than 135,000 acres in and adjacent to our service area with more than 100 wells and miles of oil and gas collection lines. The Company believes that its water resources, land and infrastructure are located in one of the most attractive areas of the Denver metropolitan region because it is well positioned for substantial growth over the next 30 years.

## **Land Development**

We are developing an approximately 930-acre Master Planned Community along the I-70 corridor that is planned to include 3,200 single family and multifamily homes, parks, open spaces, trails, recreational centers, schools, and over 2 million square feet of retail, commercial and light industrial space just four miles south of DIA. Our land development activities include the design, permitting, and construction of all of the horizontal infrastructure, including, storm water, drainage, roads, curb, sidewalks, parks, open space, trails and other infrastructure to deliver “ready to build” finished lots to home builders and commercial customers. Our land development activities generate revenue from the sale of finished lots as well as construction revenues from activities where we construct infrastructure on behalf of others. Land development revenues come from our home builder customers under specific agreements for the delivery of finished lots as well as reimbursements for the construction of public improvements, such as roads, curbs, storm water, drainage, sidewalks, parks, open space, trails etc., which come from the local governmental entity, the CAB, subject to the approval and issuance of municipal bonds to fund such reimbursements.

Our land development activities provide a strategic complement to our water utility segment as a significant component of any master planned community is providing high quality domestic water, irrigation water, and wastewater service to the community. Having control

over land and utility development enables us to build infrastructure for water, irrigation, wastewater, distribution, collection, storm water, roads, parks, open spaces and other investments efficiently, and to manage delivery of these investments to match take-down commitments from our home builder customers without significant excess capacity in any of these investments.

In June 2017, we entered into the Builder Contracts with three separate home builders (Richmond American Homes, Taylor Morrison, and KB Home) pursuant to which we agreed to sell, and the builders agreed to purchase, 506 total single-family, detached residential lots at the Sky Ranch property.

We are obligated, pursuant to the Builder Contracts to construct infrastructure and other improvements, such as roads, curbs and gutters, park amenities, sidewalks, street and traffic signs, water and sanitary sewer mains and stubs, storm water management facilities, and lot grading improvements for delivery of finished lots to each builder. Pursuant to the Builder Contracts, we must cause the Rangeview District to install and construct off-site infrastructure improvements (i.e., a wastewater reclamation facility and wholesale water facilities) for the provision of water and wastewater service to the property. In conjunction with approvals from Arapahoe County for the Sky Ranch project, we together with the Rangeview District and/or Sky Ranch Districts and/or the CAB are obligated to maintain a deposit account with Arapahoe County to ensure completion of the off-site infrastructure improvements. Approximately \$1,000,000 remains on deposit. We have substantially completed all of the off-site infrastructure improvements for the initial 506 residential lots. We have financed the obligations of the Rangeview District and the Sky Ranch Districts (through the CAB) as described in Note 14 – *Related Party Transactions* to the accompanying consolidated financial statements.

We estimate that the development of the finished lots for the first phase (506 lots) of Sky Ranch will require total capital of approximately \$35 million, which includes estimated reimbursable costs of approximately \$29 million that will be reimbursable to us by the CAB from the anticipated sale of the municipal bonds. Lot sales to home builders will generate approximately \$36 million in revenues, providing a margin on lots of approximately \$1 million prior to receipt of reimbursable costs, as discussed above. The Company and the CAB have agreed that no payment is required by the CAB with respect to reimbursable costs unless and until the CAB and/or the Sky Ranch Districts issue municipal bonds in an amount sufficient to reimburse us for all or a portion of advances provided or expenses incurred for reimbursables. Due to this contingency, reimbursable costs are currently included in *Inventories* and subsequently expensed through *Land development construction costs* until the point in time when bonds are issued and the CAB reimburses us for the public improvements. At that point, the portion of the reimbursable costs repaid will be recorded as a note receivable and will reduce any remaining capitalized expenses. Any reimbursable costs repaid in excess of capitalized expenses will be recognized as other income. The costs of developing lots and revenues from the sales of finished lots are expected to be incurred over several quarters, and the timing of cash flows will include certain milestone deliveries, including, but not limited to, completion of governmental approvals, installation of improvements, and completion of lot deliveries.

### **Critical Accounting Policies and Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements.

The most significant accounting estimates inherent in the preparation of our financial statements include estimates associated with the timing of revenue recognition, the impairment of water assets and other long-lived assets, fair value estimates and share-based compensation. Below is a summary of these critical accounting policies.

### **Revenue Recognition**

Our revenues from our water and wastewater utility services consist mainly of monthly wholesale water usage and wastewater treatment fees, tap fees and construction fees/Special Facility funding, and consulting fees. Our revenues from land development services consist mainly of lot sales and project management service fees. As further described in Note 2 – *Summary of Significant Accounting Policies* to the accompanying financial statements, proceeds from monthly water usage fees, monthly wastewater treatment fees, and consulting fees are recognized in income each month as earned. Revenue from payments associated with lot sales are deferred until delivery of and final payment for the finished lot. Project management service fees will be recognized when the CAB and/or the Sky Ranch Districts issue municipal bonds and reimburse the Company for reimbursable costs, including project management service fees. The portion of such fees repaid will be recognized as other income.

### ***Water and Wastewater Revenue***

Monthly wholesale water usage charges are assessed to our customers based on actual metered usage each month plus a base monthly service fee assessed per SFE unit served. One SFE is a customer, whether residential, commercial or industrial, that imparts a demand on the Company’s 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. Water usage pricing uses a tiered pricing structure. We recognize wholesale water usage revenues upon delivering

water to our customers or our governmental customers' end-use customers, as applicable. Revenues recognized by us from the sale of Export Water and other portions of our Rangeview Water Supply off the Lowry Range are shown gross of royalties to the Land Board. Revenues recognized by us from the sale of water on the Lowry Range are shown net of royalties paid to the Land Board and amounts retained by the Rangeview District.

We recognize wastewater treatment revenue monthly based on a flat monthly fee and actual usage charges. The monthly wastewater treatment fees are shown net of amounts retained by the Rangeview District.

A tap fee constitutes a right to connect to the wholesale water and wastewater systems through a service line to a residential or commercial building or property, and once granted, the customer may make a physical tap into the wholesale line(s) to connect its property for water and/or wastewater service. Once connected to the water and/or wastewater systems, the customer has live service to receive metered water deliveries from our system and send wastewater into our system. We recognize water and wastewater tap fees as revenue at the time we grant a right for the customer to tap into the water or wastewater service line to obtain service.

We recognize construction fees, including fees received to construct "Special Facilities," over time as the construction is completed.

Consulting fees are fees we receive, typically on a monthly basis, from municipalities and area water providers, for contract operations services. Consulting fees are recognized monthly over time as the services are consumed based on a flat monthly fee plus charges for additional work performed.

### ***Land Development Revenue***

We sell lots at Sky Ranch pursuant to distinct agreements with each builder. These agreements follow one of two formats. One format is the sale of a finished lot, whereby the purchaser pays for a ready-to-build finished lot and payment is a lump-sum payment upon completion of the finished lot. The Company will recognize revenues at the point in time at the closing of the sale of a finished lot in which control transfers to the builder and the builder is able to obtain a building permit, as the transaction cycle will be complete and the Company will have no further obligations for the lot.

Our second format is the sale of finished lots pursuant to a development agreement, whereby we receive payments at three milestones. The first milestone payment is due upon completion of platted lots whereby we transfer title to a specified number of platted lots to each builder and receive payment for the platted lots. The second milestone payment is due upon completion of construction of wet utilities to each lot (water, sewer, and storm water), and the final payment is due upon completion of the finished lot. Because the builder (i.e., the customer) takes control of the lot at the first closing and subsequent improvements made by us improve the builder's lot as construction progresses, we account for each progress payment over time under the percent-of-completion methodology.

We act as the project manager and provide any and all services required to deliver eligible improvements for the CAB. The project management fee is five percent (5%) of actual construction costs of CAB-eligible improvements. The Company and the CAB have agreed that no payment is required by the CAB with respect to project management fees unless and until the CAB and/or the Sky Ranch Districts issue municipal bonds in an amount sufficient to reimburse us for all or a portion of advances provided or expenses incurred for reimbursables. Due to this contingency, the project management fees are being accrued to revenue with a corresponding allowance until the point in time when bonds are issued and the CAB reimburses us for the public improvements. At that point, the portion of the project management fees repaid will be recorded as a note receivable and will be recognized as other income.

### ***Other Revenue***

Up-front payments we received pursuant to the Bison Lease and the OGOA are recognized as other income on a straight-line basis over the initial term or extension of term, as applicable, of the leases.

### ***Impairment of Water Assets and Other Long-Lived Assets***

We review our long-lived assets for impairment whenever management believes events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. We measure recoverability of assets to be held and used by a comparison of the carrying amount of an asset to estimated future undiscounted net cash flows we expect to be generated by the eventual use of the asset. If such assets are considered to be impaired and therefore the costs of the assets deemed to be unrecoverable, the impairment to be recognized is the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets.

Our water assets will be utilized in the provision of water services, which inevitably will encompass many housing and economic cycles. Our water supplies are legally decreed for use through the water court. The water court decree allocates a specific amount of water (subject to continued beneficial use) for municipal and industrial uses.

***Our Water Assets*** – We determine the undiscounted cash flows for our water assets by estimating tap sales to potential new developments in our service areas and along the Front Range, using estimated future tap fees less estimated costs to provide water services, over an

estimated development period. Actual new home development in our service areas and the Front Range, actual future tap fees, and actual future operating costs inevitably will vary significantly from our estimates, which could have a material impact on our financial statements as well as our results of operations. The most significant factor impacting our future estimated cash flows from our water and wastewater segment are the amount of SFEs that come online and begin to generate revenue for us. We performed an impairment analysis as of August 31, 2019, and determined that there were no material changes and that our water assets are not impaired and their costs are deemed recoverable. Our impairment analysis is based on development occurring within areas in which we have agreements to provide water services utilizing water rights owned by us (e.g., Sky Ranch and the Lowry Range) as well as in surrounding areas, including the Front Range and the I-70 corridor. Our combined Rangeview Water Supply and Sky Ranch water assets have a carrying value of approximately \$49.2 million as of August 31, 2019. Based on the carrying value of our water rights, the long-term and uncertain nature of any development plans, current tap fees of \$26,675 and estimated gross margins, we estimate that we would need to add approximately 1,850 new water connections (requiring 7% of our portfolio) to generate net revenues sufficient to recover the costs of our Rangeview Water Supply and Sky Ranch water. If tap fees increase 5%, we would need to add approximately 1,750 new water taps (requiring 7% of our portfolio) to recover the costs of our Rangeview Water Supply and Sky Ranch water. If tap fees decrease 5%, we would need to add approximately 1,940 new water taps (requiring 7% of our portfolio) to recover the costs of our Rangeview Water Supply and Sky Ranch water.

Although the timing of actual new home development throughout the Front Range will impact our tap sale projections, it will not alter our water ownership, our service obligations to existing properties or the number of SFEs we can service.

***Our Land Development Assets*** – We determine the undiscounted cash flows from lot sales, defined under our Builder Contracts, using the costs incurred to date and estimated costs to build the remaining infrastructure for delivery of finished lots over an estimated development period. Our impairment analysis is based on comparing the lot sale price under our Builder Contracts, together with qualified reimbursables, with the cost to deliver the finished lots. Our Sky Ranch land assets under development, shown as *Inventories* on our balance sheet, have a carrying value of \$11.6 million as of August 31, 2019. Based on the carrying value of our land inventories and the estimated costs to complete finished lots, compared to revenue generated from lot sales and reimbursables, we estimate that we generate net revenues sufficient to recover the costs of our land development activities. If our costs increase 5% and our lot sale revenues remain the same pursuant to our agreements, we estimate that our recoverable reimbursable costs would increase 2.5% and that we would generate net revenues sufficient to recover the costs of our land development activities.

### **Fair Value Estimates**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market. We generally use a fair value hierarchy that has three levels of inputs, both observable and unobservable, with use of the lowest possible level of input to determine fair value. The fair value of the investment securities is based on the values reported by the financial institutions where the funds are held. These securities include only federally insured certificates of deposit and U.S. treasuries. See Note 3 – *Fair Value Measurements* to the accompanying financial statements.

### **Share-based Compensation**

We estimate the fair value of share-based payment awards made to key employees and directors on the date of grant using the Black-Scholes option-pricing model. We then expense the fair value over the vesting period of the grant using a straight-line expense model. The fair value of share-based payments requires management to estimate or calculate various inputs such as the volatility of the underlying stock, the expected dividend rate, the estimated forfeiture rate and an estimated life of each option. We do not expect any forfeiture of option grants; therefore, the compensation expense has not been reduced for estimated forfeitures. These assumptions are based on historical trends and estimated future actions of option holders and may not be indicative of actual events, which may have a material impact on our financial statements. For further details on share-based compensation expense, see Note 8 – *Shareholders' Equity* to the accompanying financial statements.

## Results of Operations

### Executive Summary

The results of our operations for the fiscal years ended August 31, 2019 and 2018 were as follows:

**Table E – Summary of Results of Operations**

	Fiscal Years Ended August 31,		Change	
			2019 versus 2018	
	2019	2018	\$	%
Millions of gallons of water delivered	356.3	406.6	(50.3)	(12)%
Water revenues generated	\$ 4,654,400	\$ 4,555,900	\$ 98,500	2%
Water and wastewater tap fee revenue	3,544,700	49,900	3,494,800	7,004%
Water delivery operating costs incurred (excluding depreciation and depletion)	\$ 1,502,400	\$ 1,379,600	\$ 122,800	9%
Water delivery gross margin %	68%	70%		
Wastewater treatment revenues	\$ 35,800	\$ 46,200	\$ (10,400)	(23)%
Wastewater treatment operating costs incurred	\$ 28,000	\$ 28,400	\$ (400)	(1)%
Wastewater treatment gross margin %	22%	39%		
Lot fee revenue	\$ 11,956,000	\$ 2,139,000	\$ 9,817,000	459%
Lot fee construction costs incurred	\$ 11,305,000	\$ 2,013,800	\$ 9,291,200	461%
Lot fee gross margin %	5%	6%		
Other income	\$ 170,600	\$ 168,200	\$ 2,400	1%
Other income costs incurred	\$ 140,100	\$ 88,300	\$ 51,800	59%
Other income gross margin %	18%	48%		
General and administrative expenses	\$ 3,106,500	\$ 2,855,100	\$ 251,400	9%
Income (loss) from continuing operations	\$ 3,528,000	\$ 132,700	\$ 3,395,300	2,559%
(Loss) income from discontinued operations	\$ —	\$ —	\$ —	0%
Net income (loss)	\$ 4,811,100	\$ 414,700	\$ 4,396,400	1,060%

### Changes in Revenues and Gross Margin

We generate revenues from water and wastewater services and land development. Water and wastewater revenues are generated from (i) monthly wholesale water usage fees and wastewater treatment fees, (ii) one-time water and wastewater tap fees and construction fees (including Special Facilities funding), and (iii) consulting fees. Land development revenues are generated from the sale of lots and project management services.

**Water and Wastewater Revenues** – Our water deliveries decreased 12% in fiscal 2019 compared to fiscal 2018. Water revenues increased 2% in fiscal 2019 compared to fiscal 2018. The changes in deliveries were primarily due to a decline in demand for water used in oil and gas activities – namely, fracking wells drilled into the Niobrara Formation. The changes in revenues were primarily due to an increase in the rate per barrel for our industrial water customers. The following table details the sources of our water sales, the number of kgal (1,000 gallons) sold, and the average price per kgal for fiscal 2019 and fiscal 2018.

**Table F – Water Revenue Summary**

Customer Type	2019			2018		
	Sales (in thousands)	kgal	Average per kgal	Sales (in thousands)	kgal	Average per kgal
On-Site	\$ 180.4	28,925.7	\$ 6.24	\$ 250.0	55,287.7	\$ 4.52
Export-						
Commercial	68.0	7,350.7	9.25	141.9	13,998.8	10.14
Wild Pointe	160.7	21,113.9	7.61	119.7	25,052.4	4.78
Sky Ranch	7.0	901.7	7.76	—	—	—
Industrial/Fracking	4,238.3	298,014.0	14.22	4,044.3	312,216.7	12.95
	<u>\$ 4,654.4</u>	<u>356,306.0</u>	<u>\$ 13.06</u>	<u>\$ 4,555.9</u>	<u>406,555.6</u>	<u>\$ 11.21</u>

Our gross margin on delivering water (not including depletion charges) was 68% in fiscal 2019 and 70% in fiscal 2018. The changes in our gross margins were due to changes in demand related to water sales to the fracking industry and our ability to offset the ECCV system costs with increased water deliveries in fiscal 2019 and fiscal 2018.

Our wastewater revenues decreased 23% in fiscal 2019 compared to fiscal 2018. Wastewater revenues fluctuations result from demand changes from our only customer.

We sold 113 water and wastewater taps at Sky Ranch and one commercial water tap at Wild Pointe during fiscal 2019, which generated revenues of approximately \$3,544,700. We sold two water taps during fiscal 2018, which generated revenues of approximately \$49,900.

No Special Facilities revenue has been recognized during the fiscal year ended August 31, 2019 and 2018.

Our consulting fees for the fiscal years ended August 31, 2019 and 2018 were \$158,600 and \$142,700, respectively, and are recognized upon the rendering of our services. Our consulting fees increased 11% in fiscal 2019 compared to fiscal 2018. The increase in fees during fiscal 2019 is due to higher consulting billings from water systems we managed in fiscal 2019 compared to fiscal 2018. Our margins have fluctuated as we allocated additional staff costs to system management.

**Land Development Revenues** – We broke ground on our first phase of Sky Ranch in March of 2018 and through the fiscal year ended August 31, 2019, we completed and sold to our home builder customers 255 finished lots, receiving total payments of \$18.1 million, of which \$15.6 million and \$2.5 million was received in fiscal 2019 and 2018, respectively, and recognized revenues of \$12.0 million and \$2.1 million in fiscal years 2019 and 2018, respectively. Additionally, we have completed improvements (including over lot grading, water, sewer, storm water), off-site improvements (including drainage), and our entry roadway (Monahan Road), for the remaining 251 lots, and carry those investments, totaling \$11.6 million in *Inventories* in our financial statements. We are working with each of our home builder customers to deliver the remaining finished lots in advance of their original contract delivery deadlines by the end of fiscal year 2020. As of October 31, 2019, 122 building permits have been issued for the construction of homes within the Development and 11 certificates of occupancy have been issued relating to homes within the Development.

We act as the project manager and provide any and all services required to deliver eligible improvements for the CAB. The project management fee is five percent (5%) of actual construction costs of CAB-eligible improvements. The Company and the CAB have agreed that no payment is required by the CAB with respect to project management fees unless and until the CAB and/or the Sky Ranch Districts issue municipal bonds in an amount sufficient to reimburse us for all or a portion of advances provided or expenses incurred for reimbursables. Due to this contingency, the project management fees are being accrued to revenue with a corresponding allowance until the point in time when bonds are issued and the CAB reimburses us for the public improvements. At that point, the portion of the project management fees repaid will be recorded as a note receivable and will be recognized as other income. We have accrued \$860,300 in project management services as of August 31, 2019.

## General and Administrative Expenses

Table G details significant items, and changes, included in our General and Administrative Expenses (“G&A Expenses”) as well as the impact that share-based compensation has on our G&A Expenses for the fiscal years ended August 31, 2019 and 2018, respectively.

**Table G – G&A Expenses**

	<b>For the Fiscal Years Ended August 31,</b>		<b>Change</b>	
	<b>2019</b>	<b>2018</b>	<b>2019 versus 2018</b>	
			<b>\$</b>	<b>%</b>
Significant G&A Expense items:				
Salary and salary-related expenses	\$ 1,530,700	\$ 1,387,500	\$ 143,200	10%
Share-based compensation	336,200	324,800	11,400	4%
Professional fees	458,200	335,500	122,700	37%
Fees paid to directors including insurance	199,900	164,800	35,100	21%
Insurance	52,700	40,900	11,800	29%
Public entity-related expenses	118,400	115,800	2,600	2%
Consulting fees	24,400	41,300	(16,900)	(41)%
Property taxes	8,200	17,700	(9,500)	(54)%
Other	377,800	426,800	(49,000)	(11)%
G&A Expenses as reported	<u>\$ 3,106,500</u>	<u>\$ 2,855,100</u>	<u>\$ 251,400</u>	<u>9%</u>

**Salary and Salary-Related Expenses** – Salary and salary-related expenses increased by 10% during fiscal 2019 as compared to fiscal 2018. The increase in fiscal 2019 compared to fiscal 2018 was the result of the increase from 19 to 29 employees to manage the development of our Sky Ranch property and our water and wastewater systems. Share-based compensation expense increased 4% during

fiscal 2019 compared to fiscal 2018 as a result of an increase in the fair value of stock option grants to non-employee members of the board of directors and employees.

**Professional Fees (mainly legal and accounting fees)** – Professional fees increased 37% during fiscal 2019 compared to fiscal 2018. The increase was primarily the result of higher general legal fees due to the builder contracts related to the Sky Ranch development, water service contracts and CAB contracts in fiscal 2019 compared to fiscal 2018.

**Fees Paid to Our Board of Directors** – Fees for our board in fiscal 2019 include \$61,100 for premiums related to our directors and officers insurance policy (this amount increased by \$1,200 from fiscal 2018). The remaining fiscal 2019 fees of \$138,800 represent amounts accrued to our board members for annual service, meeting attendance fees and travel expenses, which were higher than in fiscal 2018 due to additional board meetings in fiscal 2019. Fees for our board in fiscal 2018 include \$59,900 for premiums related to our directors and officers insurance policy. The remaining fiscal 2018 fees of \$104,900 represent amounts accrued to our board members for annual service, meeting attendance fees and travel expenses.

**Insurance** – We maintain policies for general liability insurance, workers’ compensation insurance, and casualty insurance to protect our assets. Insurance expense fluctuates based on the number of employees and premiums associated with insuring our water systems.

**Public Entity-Related Expenses** – Costs associated with being a corporation and costs associated with being a publicly traded entity consist primarily of XBRL and EDGAR conversion fees, stock exchange fees, and press releases. These costs fluctuate from year to year.

**Consulting Fees** – Consulting fees for fiscal 2019 consisted of \$4,000 for employee procurement fees and other services, \$11,600 for information technology services and \$8,800 for board advisory services related to the development of the Sky Ranch water agreements. Consulting fees for fiscal 2018 consisted of \$33,800 for employee procurement fees and other services, \$5,000 for professional services and \$2,500 for board advisory services related to the development of the Sky Ranch water agreements.

**Property Taxes** – Our property taxes in fiscal 2019 relate to our 40 acres of land that comprise the boundaries of the Rangeview District and were approximately \$8,200. Property taxes related to our Sky Ranch property in fiscal 2019 were expensed in *Lot fee construction costs*. Our property taxes in fiscal 2018 relate to our property at the Rangeview District and our Sky Ranch property and were approximately \$17,700. These taxes are based on estimated taxes paid in arrears and vary slightly from year to year based on actual assessments.

**Other Expenses** – Other expenses include typical operating expenses related to the maintenance of our office, business development, travel, and funding provided to the Rangeview District and the Sky Ranch Districts. Other expenses decreased 11% during fiscal 2019 compared to fiscal 2018. The changes were primarily the result of the timing of various expenses.

## Other Income and Expense Items

Table H – Other Items

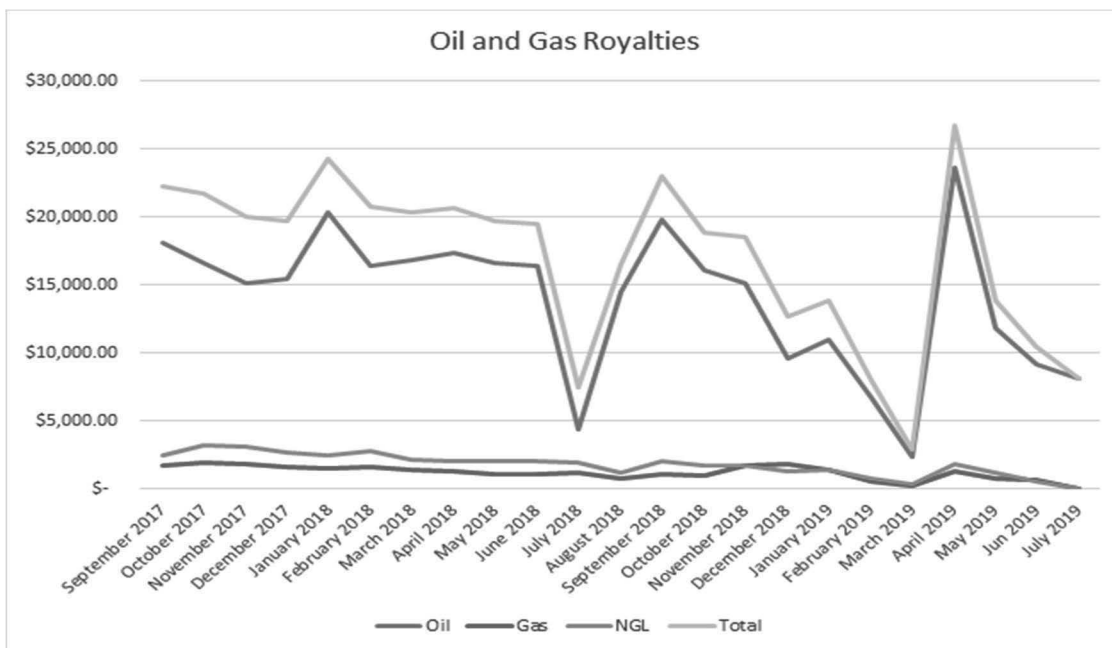
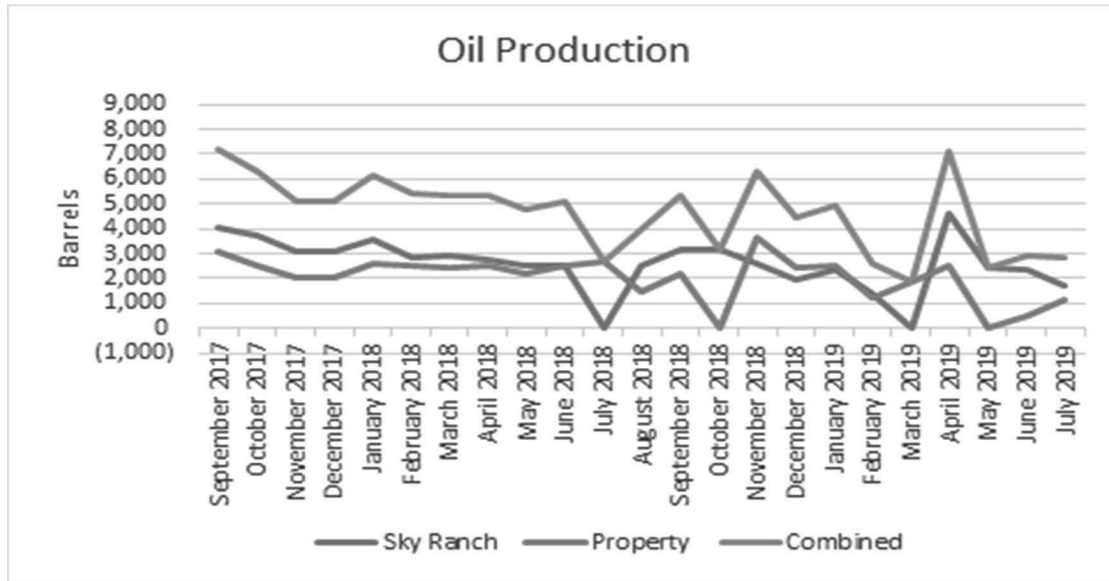
	For the Fiscal Years Ended August 31,		Change	
			2019 versus 2018	
	2019	2018	\$	%
Other income items:				
Oil and gas lease income, net	\$ 55,700	\$ 51,100	\$ 4,600	9%
Oil and gas royalty income, net	\$ 148,300	\$ 191,300	\$ (43,000)	(22)%
Interest income	\$ 298,600	\$ 206,100	\$ 92,500	45%
Other	\$ 26,600	\$ (7,100)	\$ 33,700	475%

The \$55,700 and \$51,100 of oil and gas lease payments recognized in fiscal 2019 and fiscal 2018, respectively, primarily represent the deferred recognition of the up-front payment of \$167,200 that we received in September 2017 upon entering into the Bison Lease, which payment is being recognized in income over the three year term of the Bison Lease. In July 2019, we received a payment of \$573,700 for the OGOA for three years through July 2022. We recognized \$26,200 in fiscal 2019 related to the up-front payment received pursuant to the OGOA.

The oil and gas royalty income represents amounts received pursuant to the O&G Lease. The amounts for fiscal 2019 and 2018 include royalties of each well from August 16th through August 15th, during each year, respectively. The first well (referred to as “Sky Ranch” in the chart below) generated oil and gas royalty income of approximately \$108,000 and \$163,200, 20% (net of taxes), based on the Company’s 3/8ths interest of the total production of this 1,280-acre pooled mineral estate during the fiscal years ended August 31, 2019 and 2018, respectively. This 10,000-foot horizontal well recorded production of approximately 28,400 and 40,000 barrels of oil for the fiscal years ended August 31, 2019 and 2018, respectively. The second well (referred to as “Property” in the chart below) generated oil and gas royalty income of approximately \$18,000 and \$40,400, 20% (net of taxes), based on the Company’s 1/8ths interest of the total



production of this 1,280-acre pooled mineral estate during the fiscal years ended August 31, 2019 and 2018, respectively. This 10,000-foot horizontal well recorded production of approximately 22,200 and 31,200 barrels of oil for the fiscal years ended August 31, 2019 and 2018, respectively. The following charts detail well production and oil and gas royalties during fiscal 2018 and fiscal 2019.



*Natural Gas Liquids (“NGL”) - are hydrocarbons in the same family of molecules as natural gas and crude oil, composed exclusively of carbon and hydrogen.*

Interest income represents interest earned on investment of capital in cash equivalents or debt securities and interest accrued on the notes receivable from the Rangeview District. The higher level of interest income in fiscal 2019 compared to fiscal 2018 was primarily attributable to interest rates on investments and timing of the maturity of the investments.

Other represents income we received for various easements and the construction of infrastructure for the oil and gas industry, which is partially offset by other non-operational expenses.

**Liquidity, Capital Resources and Financial Position**

At August 31, 2019, our working capital, defined as current assets less current liabilities, was \$15.2 million, which includes \$9.7 million in cash and cash equivalents, including investments with a maturity of less than 90 days. We believe that as of August 31, 2019 and as of the date of the filing of this Annual Report on Form 10-K, we had and have sufficient working capital to fund our operations for the subsequent 12 months. We manage our capital investments in the construction of finished lots for our home builder customers to match

contractual purchases required by each builder agreement. We authorize specific contracts in phases to assure adequate capital resources for the delivery of lots to our home builder customers. By way of an example, we have invested approximately \$25 million into constructing the first 255 lots at Sky Ranch. We have received approximately \$18.1 million from the sale of the lots. We seek to match completion of any new investment into lots concurrent with the contract delivery payment from our builders for such lots. On October 25, 2019, the CAB filed a preliminary offering memorandum for the offering and issuance of tax-exempt, fixed rate senior bonds in the aggregate principal amount of approximately \$10,820,000 and tax-exempt, fixed-rate subordinate bonds in the aggregate principal amount of approximately \$1,765,000. The issuance of the bonds will be dependent of market conditions and market demand for general obligation municipal bonds. The offering is intended to satisfy a portion of the CAB's obligations to reimburse us for the construction of infrastructure and other improvements at Sky Ranch. As of August 31, 2019, we have advanced the CAB approximately \$20 million that we expect will be reimbursable by the CAB. We anticipate funding our working capital needs primarily from cash receipts from the sale of lots and water and wastewater taps in fiscal 2020 and do not expect to be dependent on the receipt of the bond proceeds.

### **ECCV Capacity Operating System**

In May 2012, we entered into an agreement to operate and maintain certain wells and transmission lines, 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 cost associated with the use of the ECCV system is 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.

### **South Metropolitan Water Supply Authority and WISE**

SMWSA is a municipal water authority in the State of Colorado organized to pursue the acquisition and development of water supplies on behalf of its members, including the Rangeview District. SMWSA members include 14 Denver area water providers in Arapahoe and Douglas Counties. Pursuant to certain agreements between the Company and the Rangeview District, we agreed to provide funding to enable the Rangeview District to acquire rights to water projects undertaken by SMWSA, including the WISE water supply, 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 Rangeview District and the other nine members of the SMWA, Denver Water and Aurora Water. In exchange for funding the Rangeview District's obligations in WISE, we have the sole right to use and reuse the Rangeview District's approximate 7% share of the WISE water and infrastructure to provide water service to the Rangeview District's customers and to receive the revenue from such service. Our current WISE subscription entitles us to approximately three million gallons per day of transmission pipeline capacity and 500 acre feet per year of water. In accordance with financing agreements, to date we have provided approximately \$3.5 million of financing to the Rangeview District to fund its obligation to purchase 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 approximately \$3.0 million in connection with this system during fiscal 2020 and \$4.0 million in total for the fiscal years 2021 through 2024 to fund the Rangeview District's purchase of its share of the water transmission line and additional facilities, water and related assets for WISE.

### **Summary Cash Flows Table**

**Table I – Summary Cash Flows**

	<b>For the Fiscal Years Ended August 31,</b>		<b>Change</b>	
	<b>2019</b>	<b>2018</b>	<b>2019 versus 2018</b>	
			<b>\$</b>	<b>%</b>
Cash (used in) provided by:				
Operating activities	\$ 3,530,500	\$ 500	\$ 3,530,000	706,000%
Investing activities	\$ (10,803,800)	\$ 5,700,800	\$ (16,504,600)	(290)%
Financing activities	\$ 186,200	\$ 288,000	\$ (101,800)	(35)%

**Changes in Operating Activities** – Operating activities include revenues we receive from the sale of wholesale water and wastewater services, costs incurred in the delivery of those services, G&A Expenses, and depletion/depreciation expenses.

Cash provided by operations in fiscal 2019 increased by approximately \$3.5 million as compared to fiscal 2018, which was primarily the result of payments received relating to milestone payments from two builders at Sky Ranch that have been deferred, an upfront payment for industrial water and a payment for the OGOA that has been deferred, offset by increases in inventories related to the construction activities of Sky Ranch, and the payment of approximately \$1.0 million for a collateral deposit paid to the Arapahoe County in connection with the grading, erosion and sediment control permit application for Sky Ranch, anticipated to be refunded by 2021 coupled with the increase net income due primarily to recognized revenue from water and wastewater tap fees of \$3.5 million. Tap fee revenue in 2018 was approximately \$50,000.

**Changes in Investing Activities** – Investing activities in fiscal 2019 consisted of the sale and maturity of debt securities of approximately \$56 million offset by the purchase of approximately \$52 million in securities, the investment in our water system of approximately \$14.1 million, and the purchase of equipment of \$354,000. Investing activities in fiscal 2018 consisted of the sale and maturity of debt securities of approximately \$34 million, offset by the purchase of approximately \$23 million in securities, the investment in our water system of approximately \$1.3 million, and the purchase of equipment of \$445,300.

**Changes in Financing Activities** – Financing activities in 2019 consisted of proceeds from the exercise of stock options of \$193,100, offset by a payment to contingent liability holders of \$6,900. Financing activities in 2018 consisted of the receipt of payment on a note receivable of \$215,500 from a Sky Ranch District and proceeds from the exercise of stock options of \$75,000, offset by a payment to contingent liability holders of \$2,500.

### **Off-Balance Sheet Arrangements**

Our off-balance sheet arrangements consist entirely of the contingent portion of the Comprehensive Amendment Agreement No. 1 (the “CAA”), which is \$655,400, as described in Note 5 – *Participating Interests in Export Water* to the accompanying financial statements. The contingent liability is not reflected on our balance sheet because the obligation to pay the CAA is contingent on sales of Export Water, the amounts and timing of which are not reasonably determinable.

### **Recently Adopted and Issued Accounting Pronouncements**

See Note 2 – *Summary of Significant Accounting Policies* to the accompanying financial statements for recently adopted and issued accounting pronouncements.

### **Item 7A – Quantitative and Qualitative Disclosures About Market Risk**

Not applicable.

## Item 8 – Financial Statements and Supplementary Data

### Index to Financial Statements and Supplementary Data

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## Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors of Pure Cycle Corporation:

### ***Opinion on the Financial Statements***

We have audited the accompanying balance sheets of Pure Cycle Corporation (the “Company”) as of August 31, 2019 and 2018, the related statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the two-year period ended August 31, 2019, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of August 31, 2019 and 2018, and the results of its operations and its cash flows for each of the years in the two-year period ended August 31, 2019, in conformity with accounting principles generally accepted in the United States of America.

We also have audited the Company’s internal control over financial reporting as of August 31, 2019, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), based on criteria established in *Internal Control-Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our report dated November 12, 2019, expresses an adverse opinion.

### ***Basis for Opinion***

The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Plante & Moran PLLC

We have served as the Company’s auditor since 2017.

Boulder, CO  
November 12, 2019

## Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Pure Cycle Corporation

### **Adverse Opinion on Internal Control over Financial Reporting**

We have audited Pure Cycle Corporation's (the Company's) internal control over financial reporting as of August 31, 2019, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, because of the effect of the material weakness described in the following paragraph on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of August 31, 2019, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by COSO.

A material weakness is a control deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in management's assessment.

The control surrounding identification of accruals of costs incurred from related parties was not operating effectively to ensure that transactions were properly recorded in a timely manner. Additionally, the Company does not have adequate controls in place around preparation of the income tax provision.

This material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2019 financial statements, and this report does not affect our report dated November 12, 2019, on those financial statements.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the balance sheets and the related statements of income, comprehensive income, shareholders' equity, and cash flows of the Company, and our report dated November 12, 2019, expressed an unqualified opinion.

### **Basis for Opinion**

The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

### **Definition and Limitations of Internal Control over Financial Reporting**

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Plante & Moran PLLC

Boulder, CO  
November 12, 2019

**PURE CYCLE CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

<b>ASSETS:</b>	<u>August 31, 2019</u>	<u>August 31, 2018</u>
Current Assets:		
Cash and cash equivalents	\$ 4,478,020	\$ 11,565,038
Short-term investments	5,188,813	8,717,967
Trade accounts receivable, net	1,099,631	1,067,268
Prepaid expenses and deposits	1,016,751	1,372,886
Inventories	11,613,112	5,195,059
Taxes receivable	141,410	—
Total current assets	<u>23,537,737</u>	<u>27,918,218</u>
Long-term investments	—	190,370
Investments in water and water systems, net	50,270,310	36,721,884
Land and mineral interests	5,104,477	4,659,569
Notes receivable – related parties, including accrued interest	988,381	906,199
Other assets	1,945,202	777,734
Long-term land investment	450,641	450,641
Deferred tax asset	1,283,246	282,000
Taxes receivable	141,410	—
Total assets	<u>\$ 83,721,404</u>	<u>\$ 71,906,615</u>
<b>LIABILITIES:</b>		
Current liabilities:		
Accounts payable	170,822	787,662
Accrued liabilities	3,428,418	849,538
Deferred revenues	3,991,535	361,050
Deferred oil and gas lease and water sales payment	706,464	55,733
Total current liabilities	<u>8,297,239</u>	<u>2,053,983</u>
Deferred oil and gas lease and water sales payment, less current portion	360,884	60,378
Participating Interests in Export Water Supply	332,140	339,035
Total liabilities	<u>8,990,264</u>	<u>2,453,396</u>
Commitments and contingencies		
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock:		
Series B – par value \$.001 per share, 25 million shares authorized; 432,513 shares issued and outstanding (liquidation preference of \$432,513)	433	433
Common stock:		
Par value 1/3 of \$.01 per share, 40 million shares authorized; 23,826,598 and 23,764,098 shares issued and outstanding, respectively	79,427	79,218
Collateral stock	—	—
Additional paid-in capital	172,360,413	171,831,293
Accumulated other comprehensive income	3,891	66,446
Accumulated deficit	(97,713,023)	(102,524,171)
Total shareholders' equity	<u>74,731,141</u>	<u>69,453,219</u>
Total liabilities and shareholders' equity	<u>\$ 83,721,404</u>	<u>\$ 71,906,615</u>

See accompanying Notes to Financial Statements

**PURE CYCLE CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**

	<b>For the Fiscal Years Ended August 31,</b>	
	<b>2019</b>	<b>2018</b>
Revenues:		
Metered water usage	\$ 4,654,344	\$ 4,555,912
Wastewater treatment fees	35,818	46,199
Special facility funding recognized	—	—
Water tap fees recognized	3,544,737	49,948
Lot sales	11,955,989	2,138,950
Other income	170,621	168,190
Total revenues	20,361,509	6,959,199
Expenses:		
Water service operations	(1,502,370)	(1,379,644)
Wastewater service operations	(28,020)	(28,350)
Land development construction costs	(11,304,962)	(2,013,840)
Other	(140,118)	(88,318)
Depletion and depreciation	(968,229)	(651,449)
Total cost of revenues	(13,943,699)	(4,161,601)
Gross profit	6,417,810	2,797,598
General and administrative expenses	(3,106,548)	(2,855,095)
Depreciation	(312,602)	(251,230)
Operating income (loss)	2,998,661	(308,727)
Other income (expense):		
Oil and gas lease income, net	55,733	51,089
Oil and gas royalty income, net	148,327	191,309
Interest income	298,605	206,138
Other	26,627	(7,129)
Net income before taxes	3,527,953	132,680
Income tax benefit	1,283,195	282,000
Net income	\$ 4,811,148	\$ 414,680
Unrealized holding (losses) gains	(62,556)	77,551
Total comprehensive income	\$ 4,748,592	\$ 492,231
Basic and diluted net income per common share	\$ 0.20	\$ 0.02
Weighted average common shares outstanding – basic	23,795,973	23,760,765
Weighted average common shares outstanding – diluted	24,002,836	23,930,535

See accompanying Notes to Financial Statements



**PURE CYCLE CORPORATION**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

	<b>Preferred Stock</b>		<b>Common Stock</b>		<b>Additional Paid-in Capital</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Accumulated Deficit</b>	<b>Total</b>
	<b>Shares</b>	<b>Amount</b>	<b>Shares</b>	<b>Amount</b>				
August 31, 2017 balance:	432,513	433	23,754,098	79,185	171,431,486	(11,105)	(103,993,900)	67,506,099
Share-based compensation	—	—	—	—	324,840	—	—	324,840
Exercise of options	—	—	10,000	33	74,967	—	—	75,000
Adoption of accounting standards	—	—	—	—	—	—	1,055,049	1,055,049
Net income	—	—	—	—	—	—	414,680	414,680
Unrealized holding gain on investments	—	—	—	—	—	77,551	—	77,551
August 31, 2018 balance:	432,513	433	23,764,098	79,218	171,831,293	66,446	(102,524,171)	69,453,219
Share-based compensation	—	—	—	—	336,228	—	—	336,228
Exercise of options	—	—	62,500	209	192,892	—	—	193,101
Net income	—	—	—	—	—	—	4,811,148	4,811,148
Unrealized holding loss on investments	—	—	—	—	—	(62,556)	—	(62,556)
August 31, 2019 balance:	432,513	\$ 433	23,826,598	\$ 79,427	\$ 172,360,413	\$ 3,891	\$ (97,713,023)	\$ 74,731,141

See accompanying Notes to Financial Statements

**PURE CYCLE CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>For the Fiscal Years Ended August</b>	
	<b>31,</b>	
	<b>2019</b>	<b>2018</b>
Cash flows from operating activities:		
Net income	\$ 4,811,148	\$ 414,680
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Share-based compensation expense	336,228	324,840
Depreciation and depletion	1,280,830	902,676
Bad debt (recovery) expense	(37,233)	79,860
Investment in Well Enhancement and Recovery Systems LLC	6,601	10,490
Interest income and other non-cash items	(420)	(2,366)
Interest added to receivable from related parties	(41,776)	(17,728)
Deferred income taxes	(1,284,066)	—
Changes in operating assets and liabilities:		
Inventories	(5,018,452)	(1,217,292)
Trade accounts receivable	4,870	(369,923)
Prepaid expenses and other assets	(700,063)	(959,394)
Note receivable – related parties	(40,406)	(110,161)
Accounts payable and accrued liabilities	(368,456)	750,078
Income taxes	—	(282,000)
Deferred revenues	3,630,485	360,611
Deferred income – oil and gas lease	951,237	116,111
Net cash provided by operating activities	3,530,527	482
Cash flows from investing activities:		
Investments in water, water systems and land	(14,106,724)	(1,046,911)
Investments in Sky Ranch pipeline	—	(241,819)
Investments in Sky Ranch land development	—	(3,977,767)
Sales and maturities of marketable securities	55,697,933	34,057,552
Purchase of short-term investments	(52,040,964)	(22,645,017)
Purchase of long-term investments	—	—
Purchase of property and equipment	(353,996)	(445,286)
Net cash (used in) provided by investing activities	(10,803,751)	5,700,752
Cash flows from financing activities:		
Proceeds from note receivable – related parties	—	215,504
Proceeds from exercise of options	193,101	75,000
Payment to contingent liability holders	(6,896)	(2,523)
Net cash provided in financing activities	186,205	287,981
Net change in cash and cash equivalents	(7,087,019)	5,989,215
Cash and cash equivalents – beginning of year	11,565,038	5,575,823
Cash and cash equivalents – end of year	\$ 4,478,019	\$ 11,565,038

**SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES**

Inventories included in accounts payable and accrued liabilities	\$ 1,399,602	\$ —
Investments in water, water systems and land included in accounts payable and accrued liabilities	\$ 930,895	\$ —
Transfer of income taxes to income taxes receivable	\$ 282,820	\$ —
Transfer of prepaid asset to other asset	—	89,609
Transfer of land and development costs to inventory	\$ —	\$ 3,977,767

See accompanying Notes to Financial Statements

**PURE CYCLE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**August 31, 2019 and 2018**

**NOTE 1 – ORGANIZATION**

Pure Cycle Corporation (the “Company”) was incorporated in Delaware in 1976 and reincorporated in Colorado in 2008. The Company operates in two business segments; (i) developing wholesale water and wastewater systems in the water-short Denver metropolitan area, and (ii) developing a Master Planned Community on approximately 930 acres of land located along the Interstate 70 corridor (“I-70”), approximately four miles south of Denver International Airport (“DIA”), which is planned to include a mix of 3,200 single-family and multifamily residential units and over 2 million square feet of commercial, retail, and industrial space. The Company has accumulated valuable water and land interests over the past 30 years and has developed an extensive network of wholesale water production, storage, treatment, and distribution systems, and wastewater collection and treatment systems which serve domestic, commercial and industrial customers in the Denver metropolitan region. The Company's land assets are located in one of the most active development areas in the Denver metropolitan region along I-70.

As of August 31, 2019, the Company had approximately \$15.2 million of working capital, which included approximately \$9.7 million of cash and cash equivalents, including investments with maturities less than 90 days.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Principles of Consolidation**

The consolidated financial statements of the Company include the accounts of Pure Cycle Corporation and its majority-owned and controlled subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

**Reclassifications**

Certain reclassifications have been made to the financial statements to conform to the consolidated 2019 financial statement presentation. These reclassifications had no effect on net earnings or cash flows previously reported.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used to account for certain items such as revenue recognition, reimbursable costs and expenses, costs of revenue for lot sales, share-based compensation, deferred tax asset valuation, and the useful lives of assets. Actual results could differ from those estimates.

**Cash and Cash Equivalents**

Cash and cash equivalents include all highly liquid debt instruments with original maturities of three months or less. The Company's cash equivalents are comprised entirely of money market funds maintained at a reputable financial institution and U.S. Treasury debt securities. At various times during the fiscal year ended August 31, 2019, the Company's main operating account exceeded federally insured limits. The Company has never suffered a loss due to such excess balance.

**Land Development Inventories**

Inventories primarily include land held for development and sale. Inventories are stated at cost. Capitalized lot development costs at Sky Ranch are costs incurred to construct lots at Sky Ranch that meet the Company's capitalization criteria for improvements to a lot and are capitalized as incurred. The Company capitalizes certain legal, engineering, design, permitting, land acquisition, and construction costs related to the development of lots at Sky Ranch. The Company uses the specific identification method for the purpose of accumulating land development costs and allocates costs to each lot to determine the cost basis for each lot sale. The Company records all land cost of sales over time based on inputs of costs incurred to date to total estimated costs to complete.

In accordance with Accounting Standards Codification (“ASC”) Topic 360, *Property, Plant and Equipment* (“ASC 360”), the Company values land held for sale at the lower of the carrying value or net realizable value. In determining net realizable value, the Company primarily relies upon the most recent negotiated price that is a Level 2 input (see Note 3 – *Fair Value Measurements* for definitions of fair value inputs). If a negotiated price is not available, the Company will consider several factors, including, but not limited to, current market conditions, recent comparable sales transactions and market analysis studies. If the net realizable value is lower than the current carrying value, the land is written down to its estimated net realizable value.

## **Investments**

Management determines the appropriate classification of its investments in certificates of deposit and treasury securities at the time of purchase and reevaluates such determinations each reporting period.

Certificates of deposit and debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. The Company has \$192,800 of investments classified as held-to-maturity at August 31, 2019, which represent certificates of deposit that mature within 12 months and are, therefore, classified as short-term. Securities that the Company does not have the positive intent or ability to hold to maturity, including debt securities, are classified as available for sale securities and reported at their fair value. Changes in value on such securities are recorded as a component of *Accumulated other comprehensive income (loss)*. The cost of securities sold is based on the specific identification method. The Company's treasury securities are typically 30-day maturities.

## **Concentration of Credit Risk and Fair Value**

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents and investments. From time to time, the Company places its cash in money market instruments, certificates of deposit and U.S. government treasury obligations. To date, the Company has not experienced significant losses on any of these investments.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value.

***Cash and Cash Equivalents*** – The Company's cash and cash equivalents are reported using the values as reported by the financial institution where the funds are held. These securities primarily include balances in the Company's operating and savings accounts. The carrying amount of cash and cash equivalents approximate fair value.

***Trade Accounts Receivable*** – The Company records accounts receivable net of allowances for uncollectible accounts and the carrying value approximate fair value due to the short-term nature of the receivables.

***Investments*** – The carrying amounts of investments approximate fair value. Investments are described further in Note 3 – *Fair Value Measurements*.

***Accounts Payable*** – The carrying amounts of accounts payable approximate fair value due to the relatively short period to maturity for these instruments.

***Long-Term Financial Liabilities*** – The Comprehensive Amendment Agreement No. 1 (the "CAA") is comprised of a recorded balance and an off-balance sheet or "contingent" obligation associated with the Company's acquisition of its "Rangeview Water Supply" (as defined in Note 4 – *Water and Land Assets*). The amount payable is a fixed amount but is repayable only upon the sale of "Export Water" (as defined in Note 4 – *Water and Land Assets*). Because of the uncertainty of the sale of Export Water, the Company has determined that the contingent portion of the CAA does not have a readily determinable fair value. The CAA is described further in Note 5 – *Participating Interests in Export Water*.

***Notes Receivable – Related Parties*** – The carrying amounts of the *Notes receivable – related parties* (including with the Rangeview Metropolitan District (the "Rangeview District") and the Sky Ranch Community Authority Board (the "CAB")) approximate their fair value because the interest rates on the notes approximate market rates.

***Off-Balance Sheet Instruments*** – The Company's off-balance sheet instruments consist entirely of the contingent portion of the CAA. Because repayment of this portion of the CAA is contingent on the sale of Export Water, which is not reasonably estimable, the Company has determined that the contingent portion of the CAA does not have a determinable fair value. See further discussion in Note 5 – *Participating Interests in Export Water*.

## **Cash Flows**

The Company did not have any debt during the fiscal years ended August 31, 2019 and 2018, and therefore did not pay any interest during the fiscal years ended August 31, 2019 and 2018.

The Company did not pay any income taxes during the fiscal year ended August 31, 2018.

## **Trade Accounts Receivable**

The Company records accounts receivable net of allowances for uncollectible accounts. The Company has not recorded an allowance for uncollectible accounts in receivables from continuing operations for either of the periods ended August 31, 2019 or 2018. The

allowance for uncollectible accounts was determined based on a specific review of all past due accounts.

### **Long-Lived Assets**

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the eventual use of the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. The Company determined that no indicators were noted which would result in an impairment of the Company's long-lived assets for the period ended August 31, 2019 and 2018.

### **Capitalized Costs of Water and Wastewater Systems and Depreciation and Depletion Charges**

Costs to construct water and wastewater systems that meet the Company's capitalization criteria are capitalized as incurred, including interest, if applicable, and depreciated on a straight-line basis over their estimated useful lives of up to 30 years. The Company capitalizes design and construction costs related to construction activities, and it capitalizes certain legal, engineering and permitting costs relating to the adjudication and improvement of its water assets.

The Company depletes its water assets that are being utilized on the basis of units produced (i.e., thousands of gallons sold) divided by the total volume of water adjudicated in the water decrees.

### **Revenue Recognition**

The Company disaggregates revenue by major product line as reported on the consolidated statements of operations and comprehensive income.

The Company generates revenues through two lines of business. Revenues are derived through its wholesale water and wastewater business and through the sale of developed land primarily for residential lots, both of which businesses are described below.

The Company generates revenues through its wholesale water and wastewater business predominantly from three sources: (i) monthly wholesale water usage fees and wastewater service fees, (ii) one-time water and wastewater tap fees and construction fees/Special Facility funding, and (iii) consulting fees. Because these items are separately delivered and distinct, the Company accounts for each of the items separately, as described below.

#### ***Wholesale Water and Wastewater Fees***

- (i) **Monthly water usage and wastewater treatment fees** – Monthly wholesale water usage charges are assessed to the Company's customers based on actual metered usage each month plus a base monthly service fee assessed per single family equivalent ("SFE") unit served. One SFE is a customer, whether residential, commercial or industrial, that imparts a demand on the Company's 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. Water usage pricing uses a tiered pricing structure. The Company recognizes wholesale water usage revenues at a point in time upon delivering water to its customers or its governmental customers' end-use customers, as applicable. Revenues recognized by the Company from the sale of "Export Water" and other portions of its "Rangeview Water Supply" off the Lowry Range are shown gross of royalties to the State of Colorado Board of Land Commissioners (the "Land Board"). The Company is the primary distributor of the "Export Water" and sets pricing for the sale of Export Water. Revenues recognized by the Company from the sale of water on the Lowry Range are shown net of royalties paid to the Land Board and amounts retained by the Rangeview District. For water sales on the Lowry Range, the Rangeview District is directly selling the water and deemed the primary distributor of the water. The Rangeview District sets the price for the water sales on the Lowry Range. See further description of "Export Water," the "Lowry Range," and the "Rangeview Water Supply" in Note 4 – *Water and Land Assets* under "Rangeview Water Supply and Water System."

In addition to providing domestic water, the Company provides raw water for hydraulic fracturing to industrial customers in the oil and gas industry that are located in and adjacent to its service areas. Frack water revenues are recognized at a point in time upon delivering water to a customer.

The Company delivered 356.1 million and 406.6 million gallons of water to customers during the years ended August 31, 2019 and 2018, respectively, of which 84% and 77% was used for oil and gas exploration, respectively.

The Company recognizes wastewater treatment revenues monthly based on a flat monthly fee and actual usage charges. The monthly wastewater treatment fees are shown net of amounts retained by the Rangeview District. Costs of delivering water and providing wastewater service to customers are recognized as incurred.

- (ii) Water and wastewater tap fees and construction fees/Special Facility funding – The Company has various water and wastewater service agreements, components of which may include payment of tap fees. A tap fee constitutes a right to connect to the Company’s wholesale water and wastewater systems through a service line to a residential or commercial building or property, and once granted, the customer may make a physical tap into the wholesale line(s) to connect its property for water and/or wastewater service. Once connected to the water and/or wastewater systems, the customer has live service to receive metered water deliveries from the Company’s system and send wastewater into the Company’s system. Thus, the customer has full control of the connection right as it has the ability to obtain all of the benefits from this right. As such, management has determined that tap fees are separate and distinct performance obligations.

The Company recognizes water and wastewater tap fee revenues at the time the Company grants a right for the customer to connect to the water or wastewater service line to obtain service. The Company recognized \$3,018,300 and \$49,900 of water tap fee revenues during the years ended August 31, 2019 and 2018, respectively. The water tap fees recognized are based on the amounts billed to the Rangeview District and any amounts paid to third parties pursuant to the CAA as further described in *Note 7 – Long-Term Obligations and Operating Lease*. The Company recognized \$526,400 of wastewater tap fees during the year ended August 31, 2019. No wastewater taps were sold during the year ended August 31, 2018.

The Company recognizes construction fees, including fees received to construct “Special Facilities,” over time as the construction is completed because the customer is generally able to use the property improvement to enhance the value of other assets during the construction period. Special Facilities are facilities that enable water to be delivered to a single customer 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. Management has determined that Special Facilities are separate and distinct performance obligations because these projects are contracted to construct a specific water and wastewater system or transmission pipeline and typically do not include multiple performance obligations in a contract with a customer. No Special Facilities revenue was recognized during the fiscal year ended August 31, 2019 or 2018.

As of August 31, 2019 and 2018, the Company had no contract liabilities related to water tap and construction fee/Special Facility funding revenue.

- (iii) Consulting fees – Consulting fees are fees that the Company receives, typically on a monthly basis, from municipalities and area water providers along the I-70 corridor, for contract operations services over time as services are consumed. Consulting fees are recognized monthly based on a flat monthly fee plus charges for additional work performed. The Company recognized \$158,600 and \$142,700 of consulting fees during the years ended August 31, 2019 and 2018, respectively.

### ***Land Development Activities***

The Company generates revenues through the sale of finished lots at its Sky Ranch development primarily from several sources of revenues: (i) the sale of finished lots, (ii) construction support activities, (iii) project management services, and (iv) reimbursable expenses incurred to develop certain public improvements.

- (i) Land development through the sale of finished lots – The Company acquired approximately 930 acres of land zoned as a Master Planned Community known as Sky Ranch along the I-70 corridor east of Denver, Colorado. The Company has entered into purchase and sale agreements with three separate home builders pursuant to which the Company agreed to sell, and each builder agreed to purchase, residential lots at the property. The Company began construction of lots in March 2018 and segments its reporting of the activity relating to the costs and revenues from the construction and sale of lots at Sky Ranch.

The Company sells lots at Sky Ranch pursuant to distinct agreements with each builder. These agreements follow one of two formats. One format is the sale of a finished lot, whereby the purchaser pays for a ready-to-build finished lot and payment is a lump-sum payment upon completion of the finished lot. The Company will recognize revenues at the point in time of the closing of the sale of a finished lot in which control transfers to the builder and the builder is able to obtain a building permit, as the transaction cycle will be complete and the Company will have no further obligations for the lot. During the year ended August 31, 2019, the Company received payment and recognized revenue of \$4,053,800 from one home builder in exchange for the delivery of 57 finished lots. No revenue was recognized for lot sales at a point in time during the year ended August 31, 2018.

The Company’s second format is the sale of finished lots pursuant to a development agreement with builders, whereby the Company receives payments in stages that include (i) payment upon the delivery of platted lots (which requires the Company to deliver deeded title to individual lots), (ii) a second payment upon the completion of certain infrastructure milestones, and (iii) final payment upon the delivery of the finished lot. Ownership and control of the platted lots pass to the builders once the Company closes the sale of the platted lots. Because the builder (i.e., the customer) takes control of the lot at the first closing and subsequent improvements made by the Company improve the builder’s lot as construction progresses, the Company

accounts for revenue over time with progress measured based upon costs incurred to date compared to total expected costs. Any revenue in excess of amounts entitled to be billed is reflected on the balance sheet as a contract asset, and amounts received in excess of revenue recognized are recorded as deferred revenue. As of August 31, 2019, the Company had received cumulative payments of approximately \$14.0 million under the development agreements relating to 198 lots from two home builders, of which approximately \$10.0 million of revenue was recognized over time based on the costs incurred to date compared to total expected costs for full completion of the 198 lots. For the years ended August 31, 2019 and 2018, the Company recognized approximately \$7.9 million and approximately \$2.1 million of lot sales over time, respectively. The Company had deferred revenues of \$3,991,500 and \$361,100 as of August 31, 2019 and 2018, respectively. The Company does not have any material significant payment terms as all payments are expected to be received within 12 months after the delivery of the platted lot. The Company adopted the practical expedient for financing components and does not need to account for a financing component of these lot sales as the delivery of lot sales is expected to occur within one year.

- (ii) Construction support activities – The Company performs certain construction activities at Sky Ranch. The activities performed include construction and maintenance of the grading erosion and sediment control best management practices and other construction-related services. These activities are invoiced upon completion and are included in *Inventories* and subsequently expensed through *Land development construction costs* until bonds are issued by the Sky Ranch Districts (as defined in Note 14 – *Related Party Transactions*) and/or the CAB and the CAB reimburses the Company for public improvements. The portion of the reimbursable costs that are repaid, including reimbursable costs for construction support activities, will be recorded as a note receivable and will reduce any remaining respective reimbursable capitalized expenses in *Inventories*. Any reimbursable costs paid in excess of capitalized expenses will be recognized as other income. To date, the Company has invoiced the CAB \$430,300 for construction support activities, which amount is included in *Inventories*.
- (iii) Project management services – The Company entered into two Service Agreements for Project Management Services with the CAB on May 2, 2018. The CAB was organized by Sky Ranch Metropolitan District Nos. 1 and 5 to construct, operate and maintain certain public facilities and improvements in accordance with the Sky Ranch Community Authority Board Establishment Agreement and each of the service plans for Sky Ranch Metropolitan District Nos. 1 and 5. The Company has experience in providing the services and is willing to provide such services to the CAB for reasonable consideration for the project improvements.

Pursuant to these agreements, the Company acts as the project manager and provides any and all services required to deliver the CAB-eligible improvements, including but not limited to CAB compliance; planning design and approvals; project administration; contractor agreements; and construction management and administration. The Company must submit to the CAB a monthly invoice, in a form acceptable to the CAB. The Company is responsible for all expenses it incurs in the performance of the agreements and is not entitled to any reimbursement or compensation except as defined in the agreements, unless otherwise approved in advance by the CAB in writing. The CAB is subject to annual budget and appropriation procedures and does not intend to create a multiple-fiscal year direct or indirect debt or other financial obligation. The Company receives a project management fee of five percent (5%) of actual construction costs of CAB-eligible improvements. The project management fee qualifies as a reimbursable cost to the Company. The project management fee is based only on the actual costs of the improvements; thus, items such as fees, permits, review fees, consultant or other soft costs, and land acquisition or any other costs that are not directly related to the cost of construction of CAB-eligible improvements are not included in the calculation of the project management fee. Soft costs and other costs that are not directly related to the construction of CAB-eligible improvements are included in *Inventories* and accounted for in the same manner as construction support activities as described above. The Company and the CAB have agreed that no payment is required by the CAB with respect to project management fees unless and until the CAB and/or the Sky Ranch Districts issue municipal bonds in an amount sufficient to reimburse the Company for all or a portion of advances provided or expenses incurred for reimbursables. Due to this contingency, the project management fees are being accrued to revenue with a corresponding allowance until the point in time when bonds are issued by the Sky Ranch Districts and/or the CAB and the CAB reimburses the Company for the public improvements. At that point, the portion of the project management fees repaid will be recorded as a note receivable and will be recognized as other income. To date, the Company has accrued \$860,300 in project management services to the CAB.

- (iv) Reimbursable expenses – The CAB is required to construct certain infrastructure, the costs of which qualify as reimbursable costs. Reimbursable costs include costs incurred for construction of water distribution systems, sewer collection systems, storm water system, drainage improvements, roads, curb, sidewalks, landscaping, and parks. The Company is obligated to finance this infrastructure pursuant to its agreements with the CAB (see Note 14 – *Related Party Transactions*). The Company and the CAB have agreed that no payment is required with respect to advances made by the Company or expenses incurred related to construction of improvements unless and until the CAB and/or the Sky Ranch Districts issue bonds in an amount sufficient to reimburse the Company for all or a portion of the advances made and expenses incurred. Due to this contingency, the reimbursable costs for the construction of infrastructure are included in *Inventories* and subsequently expensed through *Land development construction costs* until the point in time when municipal bonds are issued and the CAB reimburses the Company for public improvements. At that point, the portion of the reimbursable costs repaid, including reimbursable costs for the construction of infrastructure, will be recorded as a note receivable and will reduce any remaining capitalized expenses. Any reimbursable costs repaid in excess of capitalized expenses will be recognized as other income.

The Company evaluated disaggregation of revenue and has determined that no additional disaggregation of revenue is necessary.

### **Deferred Revenue**

Deferred revenues as of August 31, 2019, was comprised mainly of unearned revenue from lot sales, a Paid-Up Oil and Gas Lease between the Company and Bison Oil and Gas, LLP for the purpose of exploring for, developing, producing, and marketing oil and gas on the 40 acres of mineral estate the Company owns adjacent to the Lowry Range (the “Bison Lease”) and an Agreement on Locations of Oil and Gas Operations Area covering approximately 16 acres entered into between the Company and the operator of the O&G Lease (defined under “*Oil and Gas Lease Payments*” below) in July 2019 (the “OGO”).

Deferred revenues from lot sales for the years ended August 31, 2019 and 2018 were \$4.0 million and \$361,100, respectively.

The Company received an up-front payment of \$167,200 in fiscal 2018, which is being recognized as income on a straight-line basis over three years (the term of the Bison Lease). The Company recognized lease income of \$55,700 and \$51,100 during the fiscal years ended August 31, 2019 and 2018, respectively, related to the up-front payment received pursuant to the Bison Lease. As of August 31, 2019, the Company has deferred revenues of \$60,400 related to the Bison Lease that will be recognized into income ratably through September 2020.

The Company received an up-front payment of \$573,700 in fiscal 2019 for the OGO, which is being recognized as income on a straight-line basis over three years (the term of the agreement). If after three years the operator has not spud at least one well on the oil and gas operations area, the operator may extend the right to the OGO one additional year by paying \$75,000 to the Company. The operator may only extend the OGO for two additional years for a total of five years. The Company recognized lease income of \$26,200 during the fiscal year ended August 31, 2019 related to the up-front payment received pursuant to the OGO. As of August 31, 2019, the Company has deferred revenues of \$547,500 related to the OGO that will be recognized into income ratably through July 2022.

The Company received an up-front payment of \$425,800 in fiscal 2019, which will be recognized as income as industrial water is provided to the operator beginning in October 2019. None of this up-front payment was recognized in revenue as of August 31, 2019.

Deferred revenues by segment is as follows:

	<u>August 31, 2019</u>	<u>August 31, 2018</u>
Wholesale water and wastewater services	\$ —	\$ —
Land development activities	3,991,535	361,050
Oil and gas leases	1,067,348	116,111
Balance, end of period	<u>\$ 5,058,883</u>	<u>\$ 477,161</u>

Changes in unearned revenue were as follows:

	<u>August 31, 2019</u>	<u>August 31, 2018</u>
Balance, beginning of period	\$ 477,161	\$ 1,055,488
Cumulative effect of adoption of ASU 2014-09	—	(1,055,488)
Billings	24,943,231	2,667,200
Contract revenues recognized	(20,361,509)	(2,190,039)
Balance, end of period	<u>\$ 5,058,883</u>	<u>\$ 477,161</u>

Revenue allocated to remaining performance obligations represents contracted revenue that has not yet been recognized (“contracted not recognized revenue”), which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods. At August 31, 2019, the Company had outstanding open contracts for \$22,189,000, which primarily related to the sale of 506 lots at Sky Ranch. The Company expects to recognize approximately 70% of such revenue over the next 12 months.

### **Inventories**

Inventories primarily include land held for development and sale, which the Company has begun developing and are stated at cost. Capitalized lot development costs at Sky Ranch are costs incurred to construct finished lots at Sky Ranch that meet the Company’s capitalization criteria for improvements to a lot and are capitalized as incurred. The Company capitalizes certain legal, engineering, design, permitting, land acquisition, and construction costs related to the development of lots at Sky Ranch. The Company uses the specific identification method for purposes of accumulating land development costs and allocates costs to each lot to determine the cost basis for each lot sale. The Company will record all land cost of sales when a lot is completed and sold on a lot-by-lot basis. Costs included in *Inventories* include common area costs that the Company funded through the CAB. The Company expects that such costs will be reimbursable by the CAB. The Company will record any reimbursements as a reduction of any capitalized costs remaining in *Inventories* once the CAB has the ability to reimburse the costs (i.e., once the Sky Ranch Districts and/or the CAB has issued bonds).



In accordance with ASC 360, the Company measures land held for sale at the lower of the carrying value or net realizable value. In determining fair value, the Company primarily relies upon the most recent negotiated price that is a Level 2 input (see Note 3 – *Fair Value Measurements* for definitions of fair value inputs). If a negotiated price is not available, the Company will consider several factors, including, but not limited to, current market conditions, recent comparable sales transactions and market analysis studies. If the net realizable value is lower than the current carrying value, the land is written down to its net realizable value.

### **Royalty and Other Obligations**

Revenues from the sale of Export Water are shown gross of royalties payable to the Land Board. Revenues from the sale of water on the Lowry Range are invoiced directly by the Rangeview District, and a percentage of such collections are then paid to the Company by the Rangeview District. Water revenue from such sales are shown net of royalties paid to the Land Board and amounts retained by the Rangeview District.

### **Oil and Gas Lease Payments**

In July 2019, the Company received an up-front payment of \$573,700 for the OGOA, which will be recognized as income on a straight-line basis over three years. If after three years the operator has not spud at least one well on the OGOA, the operator may extend the right to the OGOA one additional year by paying \$75,000 to the Company. The operator may only extend the OGOA for two additional years for a total of five years. The Company recognizes the up-front payments on a straight-line basis over the terms of the respective agreements. During the fiscal years ended August 31, 2019 and 2018, the Company recognized \$26,200 and \$0, respectively, of income related to the up-front payments received pursuant to the OGOA.

The Company entered into the Bison Lease, on September 20, 2017. Pursuant to the Bison Lease, the Company received an up-front payment of \$167,200, which is being recognized as income on a straight-line basis over three years (the term of the Bison Lease). The Company recognized lease income of \$55,700 and \$51,100 during the fiscal years ended August 31, 2019 and 2018, respectively, related to the up-front payment received. As of August 31, 2019, the Company has deferred revenues of \$60,400 of income related to the Bison Lease that will be recognized into income ratably through September 2020.

As further described in Note 4 – *Water and Land Assets* below, on March 10, 2011, the Company entered into a three-year Paid-Up Oil and Gas Lease (the “O&G Lease”) and a Surface Use and Damage Agreement with Anadarko E&P Company, L.P. (“Anadarko”), which subsequently sold the O&G Lease to a wholly-owned subsidiary of ConocoPhillips Company, for the purpose of exploring for, developing, producing and marketing oil and gas on approximately 634 acres of mineral estate owned by the Company at its Sky Ranch property. In 2014, the O&G Lease was extended for an additional two years. During 2015, two wells were placed into service and began producing oil and gas and accruing royalties to the Company. The O&G Lease is now held by production. During the fiscal years ended August 31, 2019, and 2018, the Company received \$148,300 and \$191,300, respectively, in royalties attributable to these two wells. The Company classifies income from lease and royalty payments as *Other income* in the consolidated statements of operations and comprehensive income as the Company does not consider these arrangements to be an operating business activity.

### **Share-based Compensation**

The Company maintains a stock option plan for the benefit of its employees and non-employee directors. The Company recognizes share-based compensation costs as expenses over the applicable vesting period of the stock award using the straight-line method. The compensation costs to be expensed are measured at the grant date based on the fair value of the award. The Company has adopted the alternative transition method for calculating the tax effects of share-based compensation, which allows for a simplified method of calculating the tax effects of employee share-based compensation. The Company has released its full valuation allowance on its deferred tax assets as of August 31, 2019. The impact on the income tax provision for the granting and exercise of stock options during the fiscal year ended August 31, 2019, was a tax expense of approximately \$82,900. Because the Company had a full valuation allowance on its deferred tax assets as of August 31, 2018 there was approximately a \$410,600 deferred tax impact on the income tax provision as a result of the granting and exercise of stock options.

The Company recognized \$336,200 and \$324,800 of share-based compensation expenses during the fiscal years ended August 31, 2019 and 2018, respectively.

### **Income Taxes**

The Company uses a “more-likely-than-not” threshold for the recognition and de-recognition of tax positions, including any potential interest and penalties relating to tax positions taken by the Company. The Company does not have any significant unrecognized tax benefits as of August 31, 2019.

The Company’s deferred tax asset and valuation allowance was decreased by approximately \$1.2 million as a result of the decreased corporate tax rate that went into effect pursuant to H.R.1, commonly known as the Tax Cuts and Jobs Act (the “Tax Act”), signed into law on December 22, 2017. As of August 31, 2018, the Company has a \$282,000 alternative minimum tax (“AMT”) deferred tax asset

for which it does not have a valuation allowance. The Company expects to receive the AMT as a refund in future years. Most, if not all, of this credit will be refundable starting with the filing of the 2018 (fiscal year ended 2019) through 2021 (fiscal year ending 2022) tax returns, subject to limitations of Internal Revenue Code Section 382 (arises with ownership changes) and the sequestration limitation of the Balanced Budget Act of 1997. The Company will continue to evaluate the impact of the Tax Act and will record any resulting tax adjustments during fiscal 2020.

The Company maintained a valuation allowance on the net deferred tax asset other than AMT credits as of August 31, 2018. The Company has determined it is more likely than not that the Company will realize its deferred tax assets. Such assets primarily consist of operating loss carryforwards. The Company assessed the realizability of its deferred tax asset using all available evidence. In particular, the Company considered both historical results and projections of profitability for the reasonably foreseeable future periods. The Company is required to reassess its conclusions regarding the realization of its deferred tax assets at each financial reporting date. As a result of the evaluation, the Company concluded that all of the valuation allowance is no longer necessary. By releasing the valuation allowance, the Company recognized a deferred tax benefit of approximately \$1,284,100 which positively impacted the Company's results of operations and financial position.

The Company files income tax returns with the Internal Revenue Service and the State of Colorado. The tax years that remain subject to examination are fiscal 2015 through fiscal 2018. The Company does not believe that there will be any material changes in its unrecognized tax positions over the next 12 months.

The Company's policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. At August 31, 2019, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the fiscal year ended August 31, 2019 or 2018.

### **Income (Loss) per Common Share**

Income (loss) per common share is computed by dividing net income (loss) by the weighted average number of shares outstanding during each period. Common stock options of 206,860 and 169,770 common share equivalents as of August 31, 2019 and 2018, respectively, were included in the calculation of income per common share as dilutive common stock equivalents using the treasury stock method. Common stock options aggregating 50,000 common share equivalents as of August 31, 2019, have been excluded from the calculation of income per common share as their effect is anti-dilutive.

### **Recently Issued Accounting Pronouncements**

The Company continually assesses any new accounting pronouncements to determine their applicability. When it is determined that a new accounting pronouncement affects the Company's financial reporting, the Company undertakes a study to determine the consequence of the change to its consolidated financial statements and to ensure that there are proper controls in place to ascertain that the Company's consolidated financial statements properly reflect the change. New pronouncements assessed by the Company recently are discussed below:

In June 2018, the Financial Accounting Standards Board (the "FASB") issued ASU 2018-07, *Compensation — Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*. ASU 2018-07 is intended to reduce cost and complexity and to improve financial reporting for share-based payments issued to nonemployees. This standard expands the scope of Accounting Standards Codification Topic 718, *Compensation — Stock Compensation*, which currently only includes share-based payments issued to employees, to include share-based payments issued to nonemployees for goods and services. Consequently, the accounting for share-based payments to nonemployees and employees will be substantially aligned. ASU 2018-07 supersedes ASC Subtopic 505-50, *Equity — Equity-Based Payments to Non-Employees*. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within these fiscal years. The Company believes that the impact of this standard on its consolidated financial statements is immaterial.

In February 2018, the FASB issued ASU 2018-02, *Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The amendments in ASU 2018-02 allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act. Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Act and will improve the usefulness of information reported to financial statement users. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted in any interim period after issuance of the standard. The Company believes that the impact of this standard on its consolidated financial statements is immaterial.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. Among other things, these amendments require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Companies will now use forward-looking information to better inform their credit loss estimates. The standard is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently assessing the provisions of the

standard and the impact of this ASU on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. ASU 2016-02 provides guidance on the recognition, measurement, presentation, and disclosure of leases. The new standard supersedes the present GAAP standard on leases and requires substantially all leases to be reported on the balance sheet as right-of-use assets and lease obligations. This standard is effective for fiscal years beginning after December 15, 2018. The Company adopted ASU 2016-02 on September 1, 2019. The Company anticipates that the adoption will result in right-to use assets and a corresponding liability of approximately of \$750,000 on its balance sheet.

### NOTE 3 – FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market. The Company uses a fair value hierarchy that has three levels of inputs, both observable and unobservable, with use of the lowest possible level of input to determine fair value.

Level 1 — Valuations for assets and liabilities traded in active exchange markets, such as The NASDAQ Stock Market. The Company had no Level 1 assets or liabilities as of August 31, 2019 or August 31, 2018.

Level 2 — Valuations for assets and liabilities obtained from readily available pricing sources via independent providers for market transactions involving similar assets or liabilities. The Company had one and seven Level 2 assets as of August 31, 2019 and 2018, respectively, which consist of certificates of deposit and/or U.S. treasury notes.

Level 3 — Valuations for assets and liabilities that are derived from other valuation methodologies, including discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker-traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities. The Company had one Level 3 liability, the contingent portion of the CAA, as of August 31, 2019 and 2018. The Company has determined that the contingent portion of the CAA does not have a readily determinable fair value (see Note 5 – *Participating Interests in Export Water*).

The Company maintains policies and procedures to value instruments using what management believes to be the best and most relevant data available.

**Level 2 Asset – Investments.** The Company’s investments are the Company’s only financial asset measured at fair value on a recurring basis. The fair value of the investment securities is based on the values reported by the financial institutions where the funds are held. These securities include only federally insured certificates of deposit and U.S. treasuries.

The following table provides information on the assets and liabilities measured at fair value on a recurring basis as of August 31, 2019:

	<b>Fair Value Measurement Using:</b>					<b>Accumulated Unrealized Gains and (Losses)</b>
	<b>Fair Value</b>	<b>Cost / Other Value</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	
Certificates of deposit	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
U.S. treasuries	4,996,000	4,992,100	—	4,996,000	—	3,900
Total	<u>\$ 4,996,000</u>	<u>\$ 4,992,100</u>	<u>\$ —</u>	<u>\$ 4,996,000</u>	<u>\$ —</u>	<u>\$ 3,900</u>

The following table provides information on the assets and liabilities measured at fair value on a recurring basis as of August 31, 2018:

	<b>Fair Value Measurement Using:</b>					<b>Accumulated Unrealized Gains and (Losses)</b>
	<b>Fair Value</b>	<b>Cost / Other Value</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	
Certificates of deposit	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
U.S. treasuries	8,718,000	8,644,900	—	8,718,000	—	66,400
Subtotal	<u>\$ 8,718,000</u>	<u>\$ 8,644,900</u>	<u>\$ —</u>	<u>\$ 8,718,000</u>	<u>\$ —</u>	<u>\$ 66,400</u>

The Company also holds a certificate of deposit that is not carried at fair value on the consolidated balance sheets and is classified as a held-to-maturity security. As of August 31, 2019, the carrying amount of held-to-maturity securities was \$192,800. As of August 31, 2018, the carrying amount of held-to-maturity securities was \$190,400.

## NOTE 4 – WATER AND LAND ASSETS

### Investment in Water and Water Systems

The Company’s water and water systems consist of the following approximate costs and accumulated depreciation and depletion as of August 31:

	August 31, 2019		August 31, 2018	
	Costs	Accumulated Depreciation and Depletion	Costs	Accumulated Depreciation and Depletion
Rangeview water supply	\$ 14,823,800	\$ (14,700)	\$ 14,813,800	\$ (12,800)
Sky Ranch water rights and other costs	7,371,500	(757,400)	8,514,100	(561,400)
Fairgrounds water and water system	2,899,800	(1,151,000)	2,899,900	(1,062,900)
Rangeview water system	5,617,800	(372,300)	1,655,600	(261,200)
Water supply – other	4,758,200	(860,100)	4,337,200	(625,300)
Wild Pointe service rights	1,631,800	(489,800)	1,631,700	(267,700)
Sky Ranch pipeline	5,723,700	(411,600)	5,615,900	(222,000)
Lost Creek water supply	3,324,000	—	—	—
Construction in progress	8,176,600	—	267,000	—
Totals	54,327,200	(4,056,900)	39,735,200	(3,013,300)
Net investments in water and water systems	\$ 50,270,300		\$ 36,721,900	

The Company is constructing a water reclamation facility for the Sky Ranch development. The costs of the facility are being recorded in construction in progress. The Company anticipates the facility will be completed in the second quarter of fiscal 2020 at a total cost of approximately \$12 million.

### Depletion and Depreciation

The Company recorded \$1,900 and \$2,200 of depletion charges during the fiscal years ended August 31, 2019 and 2018, respectively. During the fiscal years ended August 31, 2019 and 2018, this related entirely to the Rangeview Water Supply (as defined below).

The Company recorded \$1,278,900 and \$900,500 of depreciation expense in the fiscal years ended August 31, 2019 and 2018, respectively. These figures include \$312,600 and \$251,200 of depreciation expense for other equipment not included in the table above in the fiscal years ended August 31, 2019 and 2018, respectively.

Assets Classes	Estimated Useful Lives
Wild Pointe	Units of production depletion
Rangeview water supply	Units of production depletion
Lost Creek water supply	Units of production depletion
Rangeview, Sky Ranch and WISE water systems	30 years
ECCV wells	10 years
Furniture and fixtures	5 years
Trucks and heavy equipment	5 years
Water system general (pumps, valves, etc.)	5 years
Computers	3 years
Water equipment	3 years
Software	1 year

### Rangeview Water Supply and Water System

The “Rangeview Water Supply” consists of approximately 26,985 acre feet and is a combination of tributary surface water and groundwater rights along with certain storage rights associated with the Lowry Range, a 27,000-acre property owned by the Land Board located 16 miles southeast of Denver, Colorado. Approximately \$18.4 million of Investments in Water and Water Systems on the Company’s balance sheet as of August 31, 2019, represents the costs of assets acquired or facilities constructed to extend water service to customers located on and off the Lowry Range. The recorded costs of the Rangeview Water Supply include payments to the sellers of the Rangeview Water Supply, design and construction costs and certain direct costs related to improvements to the asset, including legal and engineering fees.

The Company acquired the Rangeview Water Supply beginning in 1996 when:

- (i) The Rangeview District entered into the 1996 Amended and Restated Lease Agreement with the Land Board, which owns the

Lowry Range;

- (ii) The Company entered into the Agreement for Sale of Export Water with the Rangeview District;
- (iii) The Company entered into the 1996 Service Agreement with the Rangeview District for the provision of water service to the Rangeview District's customers on the Lowry Range; and
- (iv) In 1997, the Company entered into the Wastewater Service Agreement with the Rangeview District for the provision of wastewater service to the Rangeview District's customers on the Lowry Range.

In July 2014, the Company, the Rangeview District and the Land Board entered into the 2014 Amended and Restated Lease (the "Lease"), which superseded the original 1996 lease, and the Company and the Rangeview District entered into an Amended and Restated Service Agreement. Collectively, the foregoing agreements, as amended, are referred to as the "Rangeview Water Agreements."

Pursuant to the Rangeview Water Agreements, the Company owns 11,650 acre feet of water consisting of 10,000 acre feet of groundwater and 1,650 acre feet of average yield surface water which can be exported off the Lowry Range to serve area users (referred to as "Export Water"). The 1,650 acre feet of surface rights are subject to completion of documentation by the Land Board related to the Company's exercise of its right to substitute an aggregate gross volume of 165,000 acre feet of its groundwater for 1,650 acre feet per year of adjudicated surface water and to use this surface water as Export Water. Additionally, assuming completion of the substitution of groundwater for surface water, the Company has the exclusive right to provide water and wastewater service, through 2081, to all water users on the Lowry Range and the right to develop an additional 13,685 acre feet of groundwater and 1,650 acre feet of adjudicated surface water to serve customers either on or off the Lowry Range. The Rangeview Water Agreements also provide for the Company to use surface reservoir storage capacity in providing water service to customers both on and off the Lowry Range.

**Services on the Lowry Range** – Pursuant to the Rangeview Water Agreements, the Company designs, finances, constructs, operates and maintains the Rangeview District's water and wastewater systems to provide service to the Rangeview District's customers on the Lowry Range. The Company will operate both the water and the wastewater systems during the contract period, and the Rangeview District owns both systems. After 2081, ownership of the water system will revert to the Land Board, with the Rangeview District retaining ownership of the wastewater system.

Rates and charges for all water and wastewater services on the Lowry Range, including tap fees and usage or monthly fees, are governed by the terms of the Rangeview Water Agreements. Rates and charges are required to be not greater than the average of similar rates and charges of three surrounding municipal water and wastewater service providers, which are reassessed annually. Pursuant to the Rangeview Water Agreements, the Land Board receives a royalty of 10% or 12% of gross revenues from the sale or disposition of the water, depending on the nature and location of the purchaser of the water, except that the royalty on tap fees shall be 2% (other than taps sold for Sky Ranch which are exempt). The Company also is required to pay the Land Board a minimum annual water production fee, which will offset future royalty obligations. The Company has made minimum annual royalty payments of \$45,600. The Rangeview District retains 2% of the remaining gross revenues, and the Company receives 98% of the remaining gross revenues after the Land Board royalty. The Land Board does not receive a royalty on wastewater fees. The Company receives 100% of the Rangeview District's wastewater tap fees and 90% of the Rangeview District's wastewater usage fees (the Rangeview District retains the other 10%).

**Export Water** – The Company owns the Export Water and intends to use it to provide wholesale water and wastewater services to customers off the Lowry Range, including customers of the Rangeview District and other governmental entities and industrial and commercial customers. The Company will own all wholesale facilities required to extend water and wastewater services using its Export Water. The Company anticipates contracting with third parties for the construction of these facilities. If the Company sells Export Water, the Company is required to pay royalties to the Land Board ranging from 10% to 12% of gross revenues, except that the royalty on tap fees shall be 2% (other than taps sold for Sky Ranch which are exempt).

## **WISE**

The WISE Partnership Agreement provides for the purchase of certain infrastructure (i.e., 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. Certain infrastructure has been constructed and other infrastructure will be constructed over the next several years. During fiscal 2019, the Company made \$419,200 in capital investments in WISE. During fiscal 2018, the Company did not make any capital investments in WISE. Capitalized terms used under this caption are defined in Note 7 – *Long-Term Obligations and Operating Lease*.

## **The Arapahoe County Fairgrounds Water and Water System**

The Company owns 321 acre feet of groundwater purchased pursuant to its agreement with Arapahoe County. The Company plans to use this water in conjunction with its Rangeview Water Supply in providing water to areas outside the Lowry Range. The \$2.9 million of capitalized costs noted in the table above includes the costs to construct various Wholesale and Special Facilities, including a new deep water well, a 500,000-gallon water tank and pipelines to transport water to the Arapahoe County fairgrounds.

## **The Lost Creek Water Supply**

In August 2019, the Company purchased 150 acre feet of ditch water rights, 800 acre feet of renewable groundwater rights, 70 acre feet of deep groundwater rights and 260 acres of land in Weld County.

Total consideration for the land and water included the \$3.5 million purchase price, plus direct costs and fees of \$42,200. The Company allocated the total acquisition cost to the land and water rights based on estimates of each asset's respective fair value. The purchase of the Lost Creek land and water was accounted for as an asset acquisition.

## **Service to Customers Not on the Lowry Range**

**Sky Ranch** – In 2010, the Company purchased approximately 930 acres of undeveloped land known as Sky Ranch. The property includes the rights to approximately 830 acre feet of water. The Company plans to use this water in conjunction with its Rangeview Water Supply to provide water service to the Rangeview District's customers at Sky Ranch. The \$11.9 million of capitalized costs includes the costs to acquire the water rights and to construct various facilities.

Total consideration for the land and water included the \$7.0 million purchase price, plus direct costs and fees of \$554,100. The Company allocated the total acquisition cost to the land and water rights based on estimates of each asset's respective fair value.

In June 2017, the Company completed and placed into service its Sky Ranch pipeline, connecting its Sky Ranch water system to the Rangeview District's water system for approximately \$5.7 million.

**Wild Pointe** – On December 15, 2016, the Rangeview District, acting by and through its water activity enterprise, and Elbert & Highway 86 Commercial Metropolitan District, a quasi-municipal corporation and political subdivision of the State of Colorado, acting by and through its water enterprise (the "Elbert 86 District"), entered into a Water Service Agreement (the "Wild Pointe Service Agreement"). Subject to the conditions set forth in the Wild Pointe Service Agreement and the terms of the Company's engagement by the Rangeview District as the Rangeview District's exclusive service provider, the Company acquired, among other things, the exclusive right to provide water services to residential and commercial customers in the Wild Pointe development, located in unincorporated Elbert County, Colorado, in exchange for \$1,600,000 in cash. Pursuant to the terms of the Wild Pointe Service Agreement, the Company, in its capacity as the Rangeview District's service provider, is responsible for providing water services to all users of water services within the boundaries and service area of the Elbert 86 District and for operating and maintaining the Elbert 86 District's water system. In exchange, the Company receives 100% of system development (or tap) fees from new customers and 98% of all other fees and charges, including monthly water service revenues, remitted to the Rangeview District by the Elbert 86 District pursuant to the Wild Pointe Service Agreement. The Elbert 86 District's water system currently provides water service to approximately 200 existing SFE water connections in Wild Pointe.

## **O&G Leases**

In 2011, the Company entered into the O&G Lease with Anadarko. Pursuant to the O&G Lease, the Company received an up-front payment from Anadarko for the purpose of exploring for, developing, producing and marketing oil and gas on 634 acres of mineral estate owned by the Company at its Sky Ranch property. The O&G Lease is now held by production, entitling the Company to royalties based on production.

In September 2017, the Company entered into the three-year Bison Lease for the purpose of exploring for, developing, producing and marketing oil and gas on 40 acres of mineral estate owned by the Company adjacent to the Lowry Range.

## **Land and Mineral Interests**

As part of the 2010 Sky Ranch acquisition, the Company acquired approximately 930 acres of land that is valued at approximately \$3.1 million as of August 31, 2019. Additionally, the Company holds approximately 13,900 acres of mineral interests in Southeast Colorado in Otero, Bent and Prowers Counties and has valued these mineral interests at approximately \$1,425,500.

As of August 31, the approximate costs allocated to the Company's land and mineral interest are as follows:

	<b>August 31, 2019</b>	<b>August 31, 2018</b>
Sky Ranch land (1)	\$ 3,037,556	\$ 3,037,557
Sky Ranch development costs	423,324	196,553
Lost Creek land	218,138	—
Arkansas Valley mineral rights	1,425,459	1,425,459
Net land and mineral interests	<u>5,104,477</u>	<u>4,659,569</u>

- (1) The Company transferred \$585,700 of Sky Ranch land costs to Inventories related to the initial phase of development, consisting of 151 acres, which began in fiscal 2018.

#### NOTE 5 – PARTICIPATING INTERESTS IN EXPORT WATER

The Company acquired its Rangeview Water Supply through various amended agreements entered into in the early 1990s. The acquisition was finalized with the signing of the CAA in 1996. Upon entering into the CAA, the Company recorded an initial liability of \$11.1 million, which represented the cash that the Company received from the participating interest holders that was used to purchase the Company's Export Water (described in greater detail in Note 4 – *Water and Land Assets*). The Company agreed to remit a total of \$31.8 million of proceeds received from the sale of Export Water to the participating interest holders in return for their initial \$11.1 million investment. The obligation for the \$11.1 million was recorded as debt, and the remaining \$20.7 million contingent liability was not reflected on the Company's balance sheet because the obligation to pay this is contingent on the sale of Export Water, the amounts and timing of which are not reasonably determinable.

The CAA obligation is non-interest bearing, and if the Export Water is not sold, the parties to the CAA have no recourse against the Company. Additionally, if the Company does not sell the Export Water, the holders of the Series B Preferred Stock are not entitled to payment of any dividend and have no contractual recourse against the Company.

As the proceeds from the sale of Export Water are received and the amounts are remitted to the CAA holders, the Company allocates a ratable percentage of this payment to the principal portion (the Participating Interests in Export Water Supply liability account), with the balance of the payment being charged to the contingent obligation portion. Because the original recorded liability, which was \$11.1 million, was 35% of the original total liability of \$31.8 million, approximately 35% of each payment remitted to the CAA holders is allocated to the recorded liability account. The remaining portion of each payment, or approximately 65%, is allocated to the contingent obligation, which is recorded on a net revenue basis.

From time to time, the Company repurchased various portions of the CAA obligations, which retained their original priority. The Company did not make any CAA acquisitions during the fiscal year ended August 31, 2019 or 2018.

The Company is currently allocated approximately 88% of the total proceeds from the sale of Export Water after payment of the Land Board royalty. Additionally, as a result of the acquisitions, and the consideration from the cumulative sales of Export Water, as detailed in the table below, the remaining potential third-party obligation at August 31, 2019, is approximately \$1 million:

	<u>Export Water Proceeds Received</u>	<u>Initial Export Water Proceeds to Pure Cycle</u>	<u>Total Potential Third-party Obligation</u>	<u>Participating Interests Liability</u>	<u>Contingency</u>
Original balances	\$ —	\$ 218,500	\$ 31,807,700	\$ 11,090,600	\$ 20,717,100
<i>Activity from inception until August 31, 2016:</i>					
Acquisitions	—	28,042,500	(28,042,500)	(9,790,000)	(18,252,500)
Relinquishment	—	2,386,400	(2,386,400)	(832,100)	(1,554,300)
Option payments - Sky Ranch and The Hills at Sky Ranch	110,400	(42,300)	(68,100)	(23,800)	(44,300)
Arapahoe County tap fees	533,000	(373,100)	(159,900)	(55,800)	(104,100)
Export Water sale payments	676,500	(540,300)	(136,200)	(47,300)	(88,900)
Balance at August 31, 2017	<u>1,319,900</u>	<u>29,691,700</u>	<u>1,014,600</u>	<u>341,600</u>	<u>673,000</u>
<i>Fiscal 2018 activity:</i>					
Balance at August 31, 2018	<u>1,380,700</u>	<u>29,638,100</u>	<u>1,007,400</u>	<u>339,100</u>	<u>668,300</u>
<i>Fiscal 2019 activity:</i>					
Export Water sale payments	166,300	(146,500)	(19,800)	(6,900)	(12,900)
Balance at August 31, 2019	<u>\$ 1,547,000</u>	<u>\$ 29,491,600</u>	<u>\$ 987,600</u>	<u>\$ 332,200</u>	<u>\$ 655,400</u>

The CAA includes contractually established priorities which call for payments to CAA holders in order of their priority. This means the first payees receive their full payment before the next priority level receives any payment and so on until full repayment. Of the next approximately \$6.5 million of Export Water payouts, which at current levels would occur over several years, the Company will receive approximately \$5.7 million of revenue.

#### NOTE 6 – ACCRUED LIABILITIES

At August 31, 2019, the Company had accrued liabilities of \$3,428,400, of which \$460,500 was for accrued compensation, \$94,000 was for estimated property taxes, \$70,000 was for professional fees and the remaining \$2,803,900 was related to operating payables, of which \$1,399,600 is payable to the CAB for the development of Sky Ranch. These costs are included in *Inventories* and subsequently expensed through *Land development construction costs*. In addition, \$930,900 of the operating payables is payable to the Rangeview



District for construction costs related to the wastewater facility. These costs are also included in *Investments in water and water systems*.

At August 31, 2018, the Company had accrued liabilities of \$849,500, of which \$400,000 was for accrued compensation, \$29,000 was for estimated property taxes, \$59,000 was for professional fees and the remaining \$361,500 was related to operating payables.

## **NOTE 7 – LONG-TERM OBLIGATIONS AND OPERATING LEASE**

As of August 31, 2019 and 2018, the Company had no debt.

The Participating Interests in Export Water Supply are obligations of the Company that have no scheduled maturity dates. Therefore, these liabilities are not disclosed in tabular format. However, the Participating Interests in Export Water Supply are described in Note 5 – *Participating Interests in Export Water*.

### **WISE Partnership**

During December 2014, the Company, through the Rangeview District, consented to the waiver of all contingencies set forth in the Amended and Restated WISE Partnership – Water Delivery Agreement, dated December 31, 2013 (the “WISE Partnership Agreement”), among the City and County of Denver acting through its Board of Water Commissioners (“Denver Water”), the City of Aurora acting by and through its utility enterprise (“Aurora Water”), and the South Metro WISE Authority (“SMWA”). The SMWA was formed by the Rangeview District and nine other governmental or quasi-governmental water providers pursuant to the South Metro WISE Authority Formation and Organizational Intergovernmental Agreement, dated December 31, 2013 (the “SM IGA”), to enable the members of SMWA to participate in the regional water supply project known as the Water Infrastructure Supply Efficiency partnership (“WISE”) created by the WISE Partnership Agreement. The SM IGA specifies each member’s pro rata share of WISE and the members’ rights and obligations with respect to WISE. The WISE Partnership Agreement provides for the purchase of certain infrastructure (i.e., 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. Certain infrastructure has been constructed and other infrastructure will be constructed over the next several years. During fiscal 2019, the Company did not make any capital investments in WISE.

By consenting to the waiver of the contingencies set forth in the WISE Partnership Agreement, pursuant to the terms of the Rangeview/Pure Cycle WISE Project Financing and Service Agreement (the “WISE Financing Agreement”) between the Company and the Rangeview District, the Company has an agreement to fund the Rangeview District’s participation in WISE effective as of December 22, 2014. The Company’s cost of funding the Rangeview District’s purchase of its share of existing infrastructure and future infrastructure for WISE and funding operations and water deliveries related to WISE is projected to be approximately \$7.0 million over the next five years. See further discussion in Note 14 – *Related Party Transactions*.

### **Operating Lease**

Effective February 2018, the Company entered into an operating lease for approximately 11,393 square feet of office and warehouse space. The lease has a three-year term with payments of \$6,600 per month and an option to extend the primary lease term for a two-year period at a rate representing a 12.5% increase over the primary base payments. The change in the lease costs is not material to the Company’s operations.

## **NOTE 8 – SHAREHOLDERS’ EQUITY**

### **Preferred Stock**

The Company’s non-voting Series B Preferred Stock has a preference in liquidation of \$1.00 per share less any dividends previously paid. Additionally, the Series B Preferred Stock is redeemable at the discretion of the Company for \$1.00 per share less any dividends previously paid. In the event that the Company’s proceeds from the sale or disposition of Export Water rights exceed \$36,026,232, the Series B Preferred Stockholders will receive the next \$432,513 of proceeds in the form of a dividend. The terms of the Series B Preferred Stock prohibit payment of dividends on common stock unless all dividends accrued on the Series B Preferred Stock have been paid.

### **Equity Compensation Plan**

The Company maintains the 2014 Equity Incentive Plan (the “2014 Equity Plan”), which was approved by shareholders in January 2014 and became effective April 12, 2014. Executives, eligible employees, consultants and non-employee directors are eligible to receive options and stock grants pursuant to the 2014 Equity Plan. Pursuant to the 2014 Equity Plan, options to purchase shares of stock and restricted stock awards can be granted with exercise prices, vesting conditions and other performance criteria determined by the Compensation Committee of the Company’s board of directors. The Company has reserved 1.6 million shares of common stock for issuance under the 2014 Equity Plan. Awards to purchase 402,000 shares of the Company’s common stock have been made under the 2014 Equity Plan. Prior to the effective date of the 2014 Equity Plan, the Company granted stock awards to eligible participants under its 2004 Incentive Plan (the “2004 Incentive Plan”), which expired April 11, 2014. No additional awards may be granted pursuant to the

2004 Incentive Plan; however, awards outstanding as of April 11, 2014, will continue to vest and expire and may be exercised in accordance with the terms of the 2004 Incentive Plan.

The Company estimates the fair value of share-based payment awards on the date of grant using the Black-Scholes option-pricing model (“Black-Scholes model”). Using the Black-Scholes model, the value of the portion of the award that is ultimately expected to vest is recognized as a period expense over the requisite service period in the consolidated statements of operations and comprehensive income (loss). Option forfeitures are to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company does not expect any forfeiture of its option grants and therefore the compensation expense has not been reduced for estimated forfeitures. During fiscal year 2019, no options expired. During fiscal year 2018, 2,500 options expired. The Company attributes the value of share-based compensation to expense using the straight-line single option method for all options granted.

The Company’s determination of the estimated fair value of share-based payment awards on the date of grant is affected by the following variables and assumptions:

- The grant date exercise price – is the closing market price of the Company’s common stock on the date of grant;
- Estimated option lives – based on historical experience with existing option holders;
- Estimated dividend rates – based on historical and anticipated dividends over the life of the option;
- Life of the option – based on historical experience, option grants have lives of between five and 10 years;
- Risk-free interest rates – with maturities that approximate the expected life of the options granted;
- Calculated stock price volatility – calculated over the expected life of the options granted, which is calculated based on the weekly closing price of the Company’s common stock over a period equal to the expected life of the option; and
- Option exercise behaviors – based on actual and projected employee stock option exercises.

In fiscal 2019, the Company granted its President and non-employee directors options to purchase 50,000 and a combined 32,500 shares of the Company’s common stock pursuant to the 2014 Equity Plan, respectively. All of the options expire 10 years after the date of grant. The Company calculated the fair value of the options granted during 2019 using the Black-Scholes model.

In fiscal 2018, the Company granted its President and non-employee directors options to purchase 50,000 and a combined 32,500 shares of the Company’s common stock pursuant to the 2014 Equity Plan, respectively. All of the options expire 10 years after the date of grant. The Company calculated the fair value of the options granted during 2018 using the Black-Scholes model.

The variable assumptions used in the fair value calculations using the Black-Scholes model are as follows:

	<b>For the Fiscal Years Ended August 31,</b>	
	<b>2019</b>	<b>2018</b>
Expected term (years)	5.80	5.80
Risk-free interest rate	2.93%	2.41%
Expected volatility	41.83%	57.88%
Expected dividend yield	0%	0%
Weighted average grant-date fair value	\$ 4.60	\$ 4.41

During the fiscal years ended August 31, 2019 and 2018, 62,500 and 10,000 options were exercised, respectively.

The following table summarizes the combined stock option activity for the 2004 Incentive Plan and 2014 Equity Plan for the fiscal year ended August 31, 2019:

	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term</b>	<b>Approximate Aggregate Intrinsic Value</b>
Outstanding at August 31, 2017	465,500	\$ 4.88	6.30	\$ 1,007,740
Granted	82,500	\$ 8.05		
Exercised	(10,000)	\$ 7.50		
Forfeited or expired	(2,500)	\$ 7.50		
Outstanding at August 31, 2018	535,500	\$ 5.31	6.04	\$ 3,180,990
Granted	82,500	\$ 10.48		
Exercised	(62,500)	\$ 3.09		
Forfeited or expired	—	\$ —		
Outstanding at August 31, 2019	555,500	\$ 6.33	6.27	\$ 2,527,590

Options exercisable at August 31, 2019	<u>403,000</u> \$	5.44	5.47 \$	2,180,299
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The following table summarizes the activity and value of non-vested options as of and for the fiscal year ended August 31, 2019:

	<u>Number of Options</u>	<u>Weighted Average Grant Date Fair Value</u>
Non-vested options outstanding at August 31, 2018	155,833	\$ 3.76
Granted	82,500	4.60
Vested	(85,833)	3.46
Forfeited	—	—
Non-vested options outstanding at August 31, 2019	<u>152,500</u>	\$ 4.03

All non-vested options are expected to vest. The total fair value of options vested during the fiscal years ended August 31, 2019 and 2018, was \$297,100 and \$210,700, respectively. The weighted average grant date fair value of options granted during the fiscal years ended August 31, 2019 and 2018 was \$4.60 and \$4.41, respectively.

Share-based compensation expense for the fiscal years ended August 31, 2019 and 2018, was \$336,200 and \$324,840, respectively.

At August 31, 2019, the Company had unrecognized expenses totaling \$284,000 relating to non-vested options that are expected to vest. The weighted average period over which these options are expected to vest is less than three years. The Company has not recorded any excess tax benefits to additional paid-in capital.

### **Warrants**

As of August 31, 2019, the Company had outstanding warrants to purchase 92 shares of common stock at an exercise price of \$1.80 per share. These warrants expire six months from the earlier of:

- (i) The date that all of the Export Water is sold or otherwise disposed of,
- (ii) The date that the CAA is terminated with respect to the original holder of the warrant, or
- (iii) The date on which the Company makes the final payment pursuant to Section 2.1(r) of the CAA.

No warrants were exercised during fiscal 2019 and 2018.

### **NOTE 9 – SIGNIFICANT CUSTOMERS**

#### ***Water and Wastewater***

Pursuant to the Rangeview Water Agreements and an Export Service Agreement entered into with the Rangeview District dated June 16, 2017, the Company provides water and wastewater services on the Rangeview District's behalf to the Rangeview District's customers. Sales to the Rangeview District accounted for 4% and 6% of the Company's total water and wastewater revenues for the fiscal years ended August 31, 2019 and 2018, respectively. The Rangeview District had one significant customer, the Ridgeview Youth Services Center. The Rangeview District's significant customer accounted for 3% and 4% of the Company's total water and wastewater revenues for the fiscal years ended August 31, 2019 and 2018, respectively.

Revenues from two customers represented approximately 72% and 16% of the Company's water and wastewater revenues for the fiscal year ended August 31, 2019. Both customers are in the oil and gas industry. Revenues from one customer represented approximately 68% of the Company's water and wastewater revenues for the fiscal year ended August 31, 2018. This customer was in the oil and gas industry.

#### ***Land Development***

Revenues from three customers represented 100% (34%, 34% and 32%) of the Company's land development revenues for the fiscal year ended August 31, 2019. Revenues from two customers represented 98% of the Company's land development revenues for the fiscal year ended August 31, 2018. Of the two customers, one customer represented 66% and the second customer represented 32% of the Company's land development revenues for the fiscal year ended August 31, 2018.

The Company had accounts receivable from the Rangeview District which accounted for 40% and 3% of the Company's trade

receivables balances at August 31, 2019 and 2018, respectively. The Company had accounts receivable from one other customer which accounted for approximately 57% of its trade receivable balances at August 31, 2019. The Company had accounts receivable from two other customers which accounted for approximately 43% and 30% of its trade receivable balances at August 31, 2018, respectively. Accounts receivable from the Rangeview District's largest customer accounted for 5% and 2% of the Company's water and wastewater trade receivables as of August 31, 2019 and 2018, respectively.

#### NOTE 10 – INCOME TAXES

Deferred income taxes reflect the tax effects of net operating loss carryforwards and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets as of August 31 are as follows:

	<b>For the Fiscal Years Ended August 31,</b>	
	<b>2019</b>	<b>2018</b>
Deferred tax assets (liabilities):		
Net operating loss carryforwards	\$ 609,439	\$ 2,009,800
AMT credit carryforward	—	282,000
Accrued compensation	113,559	—
Deferred revenues	149,895	28,600
Depreciation and depletion	(46,408)	(104,900)
NQ stock options	410,633	—
Other	46,128	80,500
Valuation allowance	—	(2,014,000)
Net deferred tax asset	<u>\$ 1,283,246</u>	<u>\$ 282,000</u>

The Company maintained a valuation allowance on the net deferred tax asset other than AMT credit carryforwards as of August 31, 2018. For the fiscal year ended August 31, 2019, the Company has determined it is more likely than not that the Company will realize its deferred tax assets, which consist primarily net operating loss carryforwards. The Company assessed the realizability of its deferred tax assets using all available evidence; considering both historical results and projections of profitability for the reasonably foreseeable future periods. As a result of the Company's annual reassessment of its conclusions regarding the realization of its deferred tax assets at each financial reporting date, the Company concluded that its deferred tax assets are realizable, and therefore, the valuation allowance is no longer necessary. By releasing the valuation allowance, the Company recognized a deferred tax benefit of approximately \$1,284,100 which positively impacted the Company's results of operations and financial position.

Income taxes computed using the federal statutory income tax rate differs from the Company's effective tax rate primarily due to the following for the fiscal years ended August 31:

	<b>For the Fiscal Years Ended August 31,</b>	
	<b>2019</b>	<b>2018</b>
Expected benefit from federal taxes at statutory rate of 21% and 34% for the years 2019 and 2018	\$ 740,870	\$ 34,100
State taxes, net of federal benefit	129,123	4,600
Permanent and other differences	10,388	97,800
Change in tax rate	—	1,196,464
NOL true up	225,067	17,589
Temporary difference true up	—	240,352
NQ stock options adjustment	(348,441)	—
AMT credit carryforward	—	(282,000)
Other	(26,202)	(17,705)
Change in valuation allowance	(2,014,000)	(1,573,200)
Total income tax expense / (benefit)	<u>\$ (1,283,195)</u>	<u>\$ (282,000)</u>

At August 31, 2019, the Company has \$2.5 million of net operating loss carryforwards available for income tax purposes. The net operating loss carryforwards expire at various times beginning in 2036 and ending in 2038 for federal income tax purposes and expire at various times beginning in 2035 and ending in 2036 for state income tax purposes.

No net operating loss carryforwards expired during the fiscal year ended August 31, 2019 or 2018.

The Tax Act reduced the Company's corporate federal tax rate from 34% to 21% effective January 1, 2018. As a result, the Company is required to re-measure its deferred tax assets and liabilities using the enacted rate at which it expects them to be recovered or settled.

The effect of this re-measurement is recorded to income tax expense (benefit) in the year the tax law is enacted. The Company's deferred tax asset and full valuation allowance was decreased by approximately \$1.2 million as a result of the decreased corporate tax rate during the fiscal year ended August 31, 2018. In addition, the Company recorded a \$282,000 AMT deferred tax asset for which it does not have a valuation allowance. The Company expects to receive the AMT deferred tax asset as a refund in future years. Most, if not all, of this credit will be refundable starting with the filing of the 2018 (fiscal year ending 2019) through 2021 (fiscal year ending 2022) tax returns, subject to limitations of the Internal Revenue Code. The Company will continue to evaluate the impact of the Tax Act and will record any resulting tax adjustments during 2019.

#### NOTE 11 – 401(K) PLAN

The Company maintains a Pure Cycle Corporation 401(k) Profit Sharing Plan (the "401(k) Plan"), a defined contribution retirement plan for the benefit of its employees. The 401(k) Plan is currently a salary deferral only plan, and at this time the Company does not match employee contributions. The Company pays the annual administrative fees of the 401(k) Plan, and the 401(k) Plan participants pay the investment fees. The 401(k) Plan is open to all employees, age 21 or older, who have been employees of the Company for at least six months. During the fiscal years ended August 31, 2019 and 2018, the Company paid fees of \$6,000 and \$5,900, respectively, for the administration of the 401(k) Plan.

#### NOTE 12 – COMMITMENTS AND CONTINGENCIES

The Company has historically been involved in various claims, litigation and other legal proceedings that arise in the ordinary course of its business. The Company records an accrual for a loss contingency when its occurrence is probable and damages can be reasonably estimated based on the anticipated most likely outcome or the minimum amount within a range of possible outcomes. The Company makes such estimates based on information known about the claims and experience in contesting, litigating and settling similar claims. Disclosures are also provided for reasonably possible losses that could have a material effect on the Company's financial position, results of operations or cash flows. The Company had no contingencies where the risk of material loss was reasonably possible as of August 31, 2019.

#### NOTE 13 – SEGMENT REPORTING

An operating segment is defined as a component of an enterprise for which discrete financial information is available and is reviewed regularly by the Chief Operating Decision Maker ("CODM"), or decision-making group, to evaluate performance and make operating decisions. The Company has identified its CODM as the Chief Executive Officer.

During the year 2018, the Company began construction of lots at Sky Ranch, which the Company has identified as a segment. Currently, the Company operates its wholesale water and wastewater services segment and land development activities at Sky Ranch as its two lines of business.

The wholesale water and wastewater services business includes selling water service to customers, which water is provided by the Company using water rights owned or controlled by the Company, and developing infrastructure to divert, treat and distribute that water and collect, treat and reuse wastewater.

As part of the Company's land development activities at Sky Ranch, the Company entered into contracts for the sale of lots (see Note 2 – *Summary of Significant Accounting Policies*). The Company has identified land development and lot sales as a separate segment beginning in the fiscal year 2018.

Oil and gas royalties and licenses are a passive activity and not an operating business activity and, therefore, are not classified as a segment.

The following table summarizes wholesale water and wastewater services and land development revenue information by segment <sup>(1)</sup>:

	<b>For the Fiscal Years Ended August 31,</b>	
	<b>2019</b>	<b>2018</b>
Wholesale water and wastewater services	\$ 8,405,520	\$ 4,794,749
Land development activities	11,955,989	2,164,450
Total wholesale water and wastewater services and land development revenues	<u>\$ 20,361,509</u>	<u>\$ 6,959,199</u>

(1) The Company had other income from non-segment sources (oil and gas, interest and other) of \$529,293 and \$441,407 for the fiscal years ended August 31, 2019 and 2018, respectively.

The following table summarizes wholesale water and wastewater services and land development pretax income by segment:

	<b>For the Fiscal Years Ended August 31,</b>	
	<b>2019</b>	<b>2018</b>
Wholesale water and wastewater services	\$ 5,766,783	\$ 2,646,988
Land development activities	651,027	150,610
Depreciation, general and administrative expenses	(3,419,149)	(3,106,325)
Total income (loss) from operations	<u>\$ 2,998,661</u>	<u>\$ (308,727)</u>

The following table summarizes total assets for the Company's wholesale water and wastewater services business and land development business by segment. The assets consist primarily of water rights and water and wastewater systems in the Company's wholesale water and wastewater services segment and land, inventories and deposits in the Company's land development segment. The Company's other assets ("Corporate") primarily consist of cash and cash equivalents, equipment, mineral rights, related party notes receivables and a deferred tax asset.

	<b>August 31, 2019</b>	<b>August 31, 2018</b>
Wholesale water and wastewater services	\$ 51,588,079	\$ 36,721,884
Land development activities	16,866,542	9,497,106
Corporate	15,266,783	25,687,625
Total assets	<u>\$ 83,721,404</u>	<u>\$ 71,906,615</u>

For the years ended August 31, 2019 and 2018, the Company had asset additions of \$14.1 million and \$2.9 million, respectively, in the wholesale water and wastewater services segment.

For the years ended August 31, 2019 and 2018, the Company had asset additions of \$18.6 million and \$4.7 million, respectively, in the land development activities segment. The Company allocated \$4.8 million from other water and wastewater to its land development activities segment in fiscal 2018.

#### **NOTE 14 – RELATED PARTY TRANSACTIONS**

On December 16, 2009, the Company entered into a Participation Agreement with the Rangeview District, whereby the Company agreed to provide funding to the Rangeview District in connection with the Rangeview District joining the South Metro Water Supply Authority ("SMWSA"). The Company provided funding of \$22,200 and \$198,200 for the fiscal years ended August 31, 2019 and 2018, respectively.

Through the WISE Financing Agreement, to date the Company has made payments totaling \$3,533,300 to purchase certain rights to use existing water transmission and related infrastructure acquired by the WISE project and to construct the connection to the WISE system. The amounts are included in *Investments in water and water systems* on the Company's balance sheet as of August 31, 2019. The Company anticipates spending the following over the next five fiscal years to fund the Rangeview 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:

#### **Estimated WISE Costs**

	<b>For the Fiscal Years Ended August 31,</b>				
	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>
Operations	\$ 44,235	\$ 32,033	\$ 32,033	\$ 32,033	\$ 32,033
Water delivery	430,350	858,000	858,000	858,000	858,000
Capital	2,296,138	50,000	50,000	50,000	50,000
Other	55,000	55,000	55,000	55,000	55,000
	<u>\$ 2,825,723</u>	<u>\$ 995,033</u>	<u>\$ 995,033</u>	<u>\$ 995,033</u>	<u>\$ 995,033</u>

The Company has outstanding notes receivable of \$988,400 in the aggregate from the Rangeview District and the CAB, which are related parties, as discussed below:

The Rangeview 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 Rangeview District is governed by an elected board of directors. Eligible voters and persons eligible to serve as a director of the Rangeview District must own an interest in property within the boundaries of the Rangeview District. The Company owns certain rights and real property interests which encompass the current boundaries of the Rangeview District. Sky Ranch Metropolitan District Nos. 1, 3, 4 and 5 (the "Sky Ranch Districts") and the

CAB are quasi-municipal corporations and political subdivisions of Colorado formed for the purpose of providing service to the Company's Sky Ranch property. The current members of the board of directors of the Rangeview District, each Sky Ranch District, and the CAB consist of three employees of the Company (including the Company's President) and one independent board member.

### **The Rangeview District**

In 1995, the Company extended a loan to the Rangeview District. The loan provided for borrowings of up to \$250,000, is unsecured, and bears interest based on the prevailing prime rate plus 2% (7.25% at August 31, 2019). The maturity date of the loan is December 31, 2020. Beginning in January 2014, the Rangeview District and the Company entered into a funding agreement that allows the Company to continue to provide funding to the Rangeview District for day-to-day operations and accrue the funding into a note that bears interest at a rate of 8% per annum and remains in full force and effect for so long as the Lease remains in effect. Of the August 31, 2019 balance in *Notes receivable - related parties*, \$961,300 includes borrowings by the Rangeview District of \$546,500 and accrued interest of \$414,800. Of the August 31, 2018 balance in *Notes receivable - related parties*, \$880,700 includes borrowings by the Rangeview District of \$484,000 and accrued interest of \$396,700.

### **Sky Ranch Metropolitan District Nos. 1, 3, 4 and 5**

The Company had been providing funding to the Sky Ranch Districts, beginning in 2012 through 2016 by entering into annual Operation Funding Agreements with one of the Sky Ranch Districts obligating the Company to advance funding to the Sky Ranch District for the operation and maintenance expenses for the then-current calendar year. The Sky Ranch District paid the outstanding note receivable to the Company in November 2017. As of August 31, 2018, there was no outstanding balance under these agreements.

In November 2014, but effective as of January 1, 2014, the Company entered into a Facilities Funding and Acquisition Agreement with a Sky Ranch District obligating the Company to either finance district improvements or to construct improvements on behalf of the Sky Ranch District subject to reimbursement. Each advance or reimbursable expense accrued interest at a rate of 6% per annum. No payments were required by the Sky Ranch District unless and until the Sky Ranch District issued bonds in an amount sufficient to reimburse the Company for all or a portion of the advances and costs incurred. The CAB agreed to repay the amounts owed by the Sky Ranch District under this agreement and the agreement was terminated pursuant to the 2018 FFAA (defined and described below).

### **Sky Ranch Community Authority Board**

Pursuant to a certain Community Authority Board Establishment Agreement, as the same may be amended from time to time, Sky Ranch Metropolitan District No. 1 and Sky Ranch Metropolitan District No. 5 formed the CAB to, among other things, design, construct, finance, operate and maintain certain public improvements for the benefit of the property within the boundaries and/or service area of the Sky Ranch Districts. In order for the public improvements to be constructed and/or acquired, it is necessary for each Sky Ranch District, directly or through the CAB, to be able to fund the improvements and pay its ongoing operations and maintenance expenses related to the provision of services that benefit the property. In November 2017, but effective as of January 1, 2018, the Company entered into a Project Funding and Reimbursement Agreement ("PF Agreement") with the CAB for the Sky Ranch property. The PF Agreement required the Company to fund an agreed upon list of public improvements for Sky Ranch with respect to earthwork, erosion control, streets, drainage and landscaping at an estimated cost of \$13.2 million for calendar years 2018 and 2019. Each advance or reimbursable expense accrues interest at a rate of 6% per annum.

On September 18, 2018, the parties entered into a series of agreements, including a Facilities Funding and Acquisition Agreement with an effective date of November 13, 2017 (the "2018 FFAA"), which supersedes and consolidates the previous agreements pursuant to which

- the CAB agreed to repay the amounts owed by Sky Ranch Metropolitan District No. 5 to the Company totaling \$857,900, and the previous Facilities Funding and Acquisition Agreement entered into between the Company and Sky Ranch Metropolitan District No. 5 in 2014 was terminated;
- the PF Agreement and a June 2018 Funding Acquisition Agreement between the CAB and the Company totaling \$2.4 million were terminated;
- the CAB acknowledged all amounts owed to the Company under the terminated agreements totaling \$3.3 million, as well as amounts the Company incurred to finance the formation of the CAB; and
- the Company agreed to fund an agreed upon list of improvements to be constructed by the CAB with an estimated cost of \$30,000,000 (including improvements already funded) on an as-needed basis for calendar years 2018–2023.

All amounts owed under the terminated agreements and all amounts advanced under the 2018 FFAA, collectively totaling \$20 million, bear interest at a rate of 6% per annum. No payment is required of the CAB for advances made to the CAB or expenses incurred related to construction of improvements unless and until the CAB and/or Sky Ranch Districts issue bonds in an amount sufficient to reimburse the Company for all or a portion of advances or other expenses incurred. The CAB agrees to exercise reasonable efforts to issue bonds to reimburse the Company subject to certain limitations. In addition, the CAB agrees to utilize any available moneys not otherwise pledged to payment of debt, used for operation and maintenance expenses, or otherwise encumbered, to reimburse the Company. Any

advances not paid or reimbursed by the CAB by December 31, 2058, shall be deemed forever discharged and satisfied in full.

In 2018, the Company advanced the CAB \$2.3 million to begin construction of improvements on the Sky Ranch property. In 2019, the Company advanced the CAB \$17.7 million for the Sky Ranch property. The advances have been used by the CAB to pay for construction of public improvements and have been recorded as Inventories and subsequently expensed through *Land development construction costs* in the accompanying financial statements. If the Sky Ranch Districts and/or the CAB issues bonds and the CAB reimburses the Company, the reimbursement will reduce any applicable capitalized costs remaining in Inventories.

In September 2018, effective as of November 13, 2017, the Company entered into an Operation Funding Agreement with the CAB obligating the Company to advance funding to the CAB for operation and maintenance expenses for the 2018 and 2019 calendar years. All payments are subject to annual appropriations by the CAB in its absolute discretion. The advances by the Company accrue interest at the rate of 6% per annum from the date of the advance. \$27,100 of the balance of the *Notes receivable – related parties* at August 31, 2019, includes borrowings by the CAB of \$25,500 and accrued interest of \$1,600. The \$25,500 balance of the *Notes receivable – related parties* at August 31, 2018, includes borrowings by the CAB of \$25,500 and accrued interest of \$0.

## NOTE 15 – UNAUDITED QUARTERLY FINANCIAL DATA

### Quarterly Results of Operations

In thousands, except per share data	2019				2018			
	Three Months Ended				Three Months Ended			
	Nov 30	Feb 28	May 31	Aug 31	Nov 30	Feb 29	May 31	Aug 31
Total revenues	\$ 3,073	\$ 2,630	\$ 5,185	\$ 9,474	\$ 1,010	\$ 845	\$ 1,212	\$ 3,892
Gross profit	1,246	374	1,922	2,876	580	631	683	904
Operating income (loss)	519	(276)	1,159	1,597	(200)	(14)	(88)	(7)
Net income (loss)	\$ 634	\$ (96)	\$ 1,261	\$ 3,012	\$ (97)	\$ 100	\$ 55	\$ 357
Basic and diluted income (loss) per share	\$ 0.03	\$ *	\$ 0.05	\$ 0.13	\$ *	\$ *	\$ *	\$ 0.01

\* Amount is less than \$.01 per share

The following item had a significant impact on the Company's net income (loss):

- In fiscal 2019, the Company sold approximately \$4,238,300 (\$1,285,000, \$124,200, \$1,308,500 and \$1,520,600 in fiscal Q1, Q2, Q3 and Q4, respectively) in water related to oil and gas activities as compared to \$4,044,300 (\$846,400, \$753,000, \$1,022,300 and \$1,422,600 in fiscal Q1, Q2, Q3 and Q4, respectively) in fiscal 2018.



## **NOTE 16 – SUBSEQUENT EVENTS**

On October 25, 2019, the CAB filed a preliminary offering memorandum for the offering and issuance of tax-exempt, fixed rate senior bonds in the aggregate principal amount of approximately \$10,820,000 and tax-exempt, fixed-rate subordinate bonds in the aggregate principal amount of approximately \$1,765,000 (collectively, the “Bonds”). If the Bonds are sold successfully, approximately \$10 million of the net proceeds from the Bonds are expected to be used to reimburse the Company for advances it made to the CAB pursuant to the 2018 FFAA to fund the construction of public improvements to the Sky Ranch property.

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## **Item 9 – Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

As discussed in our Current Report on Form 8-K filed on October 4, 2018, EKS&H LLLP (“EKS&H”) resigned as our independent registered public accounting firm. EKS&H resigned because EKS&H combined with Plante & Moran PLLC (“Plante Moran”). On October 1, 2018, the Audit Committee of our board of directors engaged Plante Moran to serve as the independent registered public accounting firm for the Company effective as of that date. EKS&H had been the Company’s independent registered public accounting firm since December 4, 2017.

During the period from December 4, 2017 to August 31, 2018, and the subsequent interim period through October 1, 2018 we did not have any disagreements with EKS&H on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to EKS&H’s satisfaction, would have caused EKS&H to make reference thereto in its reports on our financial statements for the relevant periods. During the period from December 4, 2017 to August 31, 2018, and the subsequent interim period through October 1, 2018, there were no reportable events, as defined in Item 304(a)(1)(v) of Regulation S-K.

As discussed in our Current Report on Form 8-K filed on December 6, 2017, we dismissed Crowe Horwath LLP (now known as Crowe LLP) (“Crowe”) as the Company’s independent registered public accounting firm. The dismissal of Crowe was approved by the Audit Committee of the board of directors of the Company. Crowe had been the Company’s independent registered public accounting firm since January 16, 2017.

During the fiscal year ended August 31, 2017 and through December 4, 2017 (the date of the change in auditors), we did not have any disagreements with Crowe on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to Crowe’s satisfaction, would have caused Crowe to make reference thereto in its reports on our financial statements for the relevant periods. During the fiscal year ended August 31, 2017 and through December 4, 2017, there were no reportable events, as defined in Item 304(a)(1)(v) of Regulation S-K.

## **Item 9A – Controls and Procedures**

### *(a) Evaluation of Disclosure Controls and Procedures*

We maintain disclosure controls and procedures (as such term is defined in Rule 13a-15(e) of the Exchange Act) that are designed to ensure that information required to be disclosed in our reports filed or submitted to the SEC under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC’s rules and forms, and that information is accumulated and communicated to management, including the principal executive and financial officer, as appropriate, to allow timely decisions regarding required disclosures. The President and Chief Financial Officer (one person) evaluated the effectiveness of disclosure controls and procedures as of August 31, 2019, pursuant to Rule 13a-15(b) under the Exchange Act. Based on that evaluation, the President and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company’s disclosure controls and procedures were not effective.

### *(b) Management’s Annual Report on Internal Control Over Financial Reporting*

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Exchange Act. The Exchange Act defines internal control over financial reporting as a process designed by, or under the supervision of, our executive and principal financial officers and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and our directors; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in Internal Control – Integrated Framework (the “2013 COSO Framework”). Based on that evaluation, our management identified deficiencies related to our identification of expense accruals of costs incurred from related parties and the preparation of our income tax provision that constitute material weaknesses in our internal control over financial reporting as of August 31, 2019.

A material weakness is a deficiency, or combination of deficiencies, in our internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

Management is dedicated to remediating the control deficiencies that gave rise to the material weaknesses in our internal control over financial reporting. The following steps are among the measures that have been implemented or that we intend to implement in the second quarter of fiscal 2020 to address our material weaknesses as of August 31, 2019:

- We have initiated compensating controls in the near term, including designating an additional person to confirm expense accruals;
- We are enhancing and revising the design of existing controls and procedures to improve our identification of expense accruals of costs; and
- We have initiated compensating controls in the near term, including designating an external tax consulting firm to review and confirm our quarterly income tax provisions are correct and complete.

We expect that the remediation of these material weaknesses will be completed prior to the end of our fiscal 2020. We cannot assure that the measures we take will remediate the identified material weaknesses or that any additional material weaknesses will not arise in the future.

*(c) Report of the Independent Registered Public Accounting Firm*

The effectiveness of our internal control over financial reporting as of August 31, 2019, has been audited by Plante & Moran PLLC, an independent registered public accounting firm, as stated in its attestation report which is included in *Item 8 – Consolidated Financial Statements and Supplementary Data* of this Annual Report on Form 10-K.

*(d) Changes in Internal Controls*

Except as noted above, no changes were made to our internal control over financial reporting as of August 31, 2019, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B – Other Information**

None.

## **PART III**

### **Item 10 – Directors, Executive Officers and Corporate Governance**

Our board of directors has adopted a Code of Business Conduct and Ethics applicable to all of our directors, officers and employees that is available on our website at [www.purecyclewater.com](http://www.purecyclewater.com). We intend to disclose any amendments to or waivers from the provisions of our Code of Business Conduct and Ethics that are applicable to our principal executive officer, principal financial officer or principal accounting officer and that relate to any element of the SEC’s definition of code of ethics by posting such information on our website, in a press release, or on a Current Report on Form 8-K.

Information required by this item will be contained in, and is incorporated herein by reference to, our definitive Proxy Statement pursuant to Regulation 14A promulgated under the Exchange Act for the Annual Meeting of Shareholders to be held in January 2020, which is expected to be filed on or about December 5, 2019 (the “Proxy Statement”).

### **Item 11 – Executive Compensation**

The information required by this item will be included in, and is incorporated herein by reference to, our Proxy Statement.

### **Item 12 – Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by this item will be included in, and is incorporated herein by reference to, our Proxy Statement.

### **Item 13 – Certain Relationships and Related Transactions, and Director Independence**

The information required by this item will be included in, and is incorporated herein by reference to, our Proxy Statement.

### **Item 14 – Principal Accounting Fees and Services**

The information required by this item will be included in, and is incorporated herein by reference to, our Proxy Statement.

## **PART IV**

### **Item 15 – Exhibits and Financial Statement Schedules**

#### **(a) Documents filed as part of this Annual Report on Form 10-K**

- (1) Financial Statements. See “Index to Consolidated Financial Statements and Supplementary Data” in *Part II, Item 8* of this Annual Report on Form 10-K.
- (2) Financial Statement Schedules. All schedules are omitted either because they are not required or the required information is shown in the consolidated financial statements or notes thereto.
- (3) Exhibits. The exhibits listed on the accompanying “Exhibit Index” are filed or incorporated by reference as part of this Annual Report on Form 10-K, unless otherwise indicated.

#### **Item 16 – Form 10-K Summary**

None.

## EXHIBIT INDEX

Exhibit Number	Description
3.1	Articles of Incorporation of the Company. Incorporated by reference to Appendix B to the Proxy Statement on Schedule 14A filed on December 14, 2007.
3.2	Bylaws of the Company. Incorporated by reference to Appendix C to the Proxy Statement on Schedule 14A filed on December 14, 2007.
4.1	Specimen Stock Certificate. Incorporated by reference to Exhibit 4.1 to Quarterly Report on Form 10 Q for the fiscal quarter ended February 28, 2015.
4.2	Description of Capital Stock. *
10.1	2004 Incentive Plan, effective April 12, 2004. Incorporated by reference to Exhibit F to the Proxy Statement for the Annual Meeting held on April 12, 2004. **
10.2	Wastewater Service Agreement, dated January 22, 1997, by and between the Company and the Rangeview Metropolitan District. Incorporated by reference to Exhibit 10.3 to the Annual Report on Form 10-KSB for the fiscal year ended August 31, 1998.
10.3	Comprehensive Amendment Agreement No. 1, dated April 11, 1996, by and among Inco Securities Corporation, the Company, the Bondholders, Gregory M. Morey, Newell Augur, Jr., Bill Peterson, Stuart Sundlun, Alan C. Stormo, Beverlee A. Beardslee, Bradley Kent Beardslee, Robert Douglas Beardslee, Asra Corporation, International Properties, Inc., and the Land Board. Incorporated by reference to Exhibit 10.7 to the Quarterly Report on Form 10-QSB for the period ended May 31, 1996.
10.4	Agreement for Sale of Export Water dated April 11, 1996 by and between the Company and the Rangeview Metropolitan District. Incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-QSB for the fiscal quarter ended May 31, 1996.
10.5	Bargain and Sale Deed among the Land Board, the Rangeview Metropolitan District and the Company dated April 11, 1996. Incorporated by reference to Exhibit 10.18 to Amendment No. 1 to Registration Statement on Form SB-2, filed on June 7, 2004, Registration No. 333-114568.
10.6	Agreement for Water Service dated August 3, 2005 among the Company, Rangeview Metropolitan District and Arapahoe County incorporated by reference to Exhibit 10.24 to the Current Report on Form 8-K filed on August 4, 2005.
10.7	Amendment No. 1 to Agreement for Water Service dated August 25, 2008, between the Company and Arapahoe County. Incorporated by reference to Exhibit 10.36 to the Annual Report on Form 10-K for the fiscal year ended August 31, 2008.
10.8	Paid-Up Oil and Gas Lease dated March 14, 2011, between the Company and Anadarko E&P Company, L.P. Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on March 15, 2011.
10.9	Surface Use and Damage Agreement dated March 14, 2011, between the Company and Anadarko E&P Company, L.P. Incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed on March 15, 2011.
10.10	2014 Equity Incentive Plan, effective April 12, 2014. Incorporated by reference to Appendix A to the Proxy Statement for the Annual Meeting held on January 15, 2014. **
10.11	2014 Amended and Restated Lease Agreement, dated July 10, 2014, by and between the Land Board, the Rangeview Metropolitan District, and the Company. Incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed on July 14, 2014.
10.12	2014 Amended and Restated Service Agreement, dated July 10, 2014, by and between the Company and the Rangeview Metropolitan District. Incorporated by reference to Exhibit 10.5 to the Current Report on Form 8-K filed on July 14, 2014.
10.13	Rangeview/Pure Cycle WISE Project Financing and Service Agreement, effective as of December 22, 2014. Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on December 30, 2014.
10.14	South Metro WISE Authority Formation and Organizational Intergovernmental Agreement, dated December 31, 2013. Incorporated by reference to Exhibit 10.2 to Quarterly Report on Form 10-Q for the fiscal quarter ended November 30, 2014.
10.15	Amended and Restated WISE Partnership – Water Delivery Agreement, dated December 31, 2013, among the City and County of Denver acting through its Board of Water Commissioners, the City of Aurora acting by and through its Utility Enterprise, and South Metro WISE Authority. Incorporated by reference to Exhibit 10.3 to Quarterly Report on Form 10-Q for the fiscal quarter ended November 30, 2014.
10.16	Agreement for Purchase and Sale of Western Pipeline Capacity, dated November 19, 2014, among the Rangeview Metropolitan District and certain members of the South Metro WISE Authority. Incorporated by reference to Exhibit 10.4 to Quarterly Report on Form 10-Q for the fiscal quarter ended November 30, 2014.
10.17	Water Service Agreement by and between Rangeview Metropolitan District, acting by and through its Water Activity Enterprise, and Elbert & Highway 86 Commercial Metropolitan District, acting by and through its Water Enterprise, dated as of December 15, 2016. Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on December 19, 2016.

Exhibit Number	Description
10.18	Export Service Agreement, effective as of June 16, 2017, between the Company and the Rangeview Metropolitan District. Incorporated by reference to Exhibit 10.18 to the Annual Report on Form 10-K for the fiscal year ended August 31, 2017
10.19	Contract for Purchase and Sale of Real Estate, dated June 27, 2017, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by First Amendment to Contract for Purchase and Sale of Real Estate, dated August 28, 2017, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by Second Amendment to Contract for Purchase and Sale of Real Estate, dated August 29, 2017, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by Third Amendment to Contract for Purchase and Sale of Real Estate, dated September 8, 2017, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by Fourth Amendment to Contract for Purchase and Sale of Real Estate, dated September 20, 2017, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by Fifth Amendment to Contract for Purchase and Sale of Real Estate, dated October 6, 2017, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by Sixth Amendment to Contract for Purchase and Sale of Real Estate, dated October 11, 2017, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by Seventh Amendment to Contract for Purchase and Sale of Real Estate, dated October 18, 2017, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by Eighth Amendment to Contract for Purchase and Sale of Real Estate, dated October 20, 2017, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by Ninth Amendment to Contract for Purchase and Sale of Real Estate, dated October 20, 2017, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by Tenth Amendment to Contract for Purchase and Sale of Real Estate, dated November 3, 2017, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by Eleventh Amendment to Contract for Purchase and Sale of Real Estate, dated November 10, 2017, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by Twelfth Amendment to Contract for Purchase and Sale of Real Estate, dated April 20, 2018, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by <b>Thirteenth Amendment*</b> to Contract for Purchase and Sale of Real Estate, dated August 9, 2018, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by <b>Fourteenth Amendment*</b> to Contract for Purchase and Sale of Real Estate, dated March 11, 2019, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc., as amended by <b>Fifteenth Amendment*</b> to Contract for Purchase and Sale of Real Estate, dated September 26, 2019, by and between PCY Holdings, LLC and Richmond American Homes of Colorado, Inc. The Contract for Purchase and Sale of Real Estate and the First through Tenth Amendments are incorporated by reference to Exhibit 10.19 to the Annual Report on Form 10-K for the fiscal year ended August 31, 2017. The Eleventh Amendment is incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q for the fiscal quarter ended November 30, 2017. The Twelfth Amendment is incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-Q for the fiscal quarter ended May 31, 2018. The Thirteenth, Fourteenth and Fifteenth Amendments are filed herewith.



Exhibit Number	Description
10.20	<p>Contract for Purchase and Sale of Real Estate, dated June 27, 2017, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by First Amendment to Contract for Purchase and Sale of Real Estate, dated August 24, 2017, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by Second Amendment to Contract for Purchase and Sale of Real Estate, dated September 19, 2017, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by Third Amendment to Contract for Purchase and Sale of Real Estate, dated October 6, 2017, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by Fourth Amendment to Contract for Purchase and Sale of Real Estate, dated October 13, 2017, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by Fifth Amendment to Contract for Purchase and Sale of Real Estate, dated October 18, 2017, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by Sixth Amendment to Contract for Purchase and Sale of Real Estate, dated October 20, 2017, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by Seventh Amendment to Contract for Purchase and Sale of Real Estate, dated October 20, 2017, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by Eighth Amendment to Contract for Purchase and Sale of Real Estate, dated November 3, 2017, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by Ninth Amendment to Contract for Purchase and Sale of Real Estate, dated November 7, 2017, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by Tenth Amendment to Contract for Purchase and Sale of Real Estate, dated November 10, 2017, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by Eleventh Amendment to Contract for Purchase and Sale of Real Estate, dated March 27, 2018, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by Twelfth Amendment to Contract for Purchase and Sale of Real Estate, dated April 10, 2018, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by <b>Thirteenth Amendment*</b> to Contract for Purchase and Sale of Real Estate, dated August 9, 2018, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc., as amended by <b>Fourteenth Amendment*</b> to Contract for Purchase and Sale of Real Estate, dated July 19, 2019, by and between PCY Holdings, LLC and Taylor Morrison of Colorado, Inc. The Contract for Purchase and Sale of Real Estate and the First through Ninth Amendments are incorporated by reference to Exhibit 10.20 to the Annual Report on Form 10-K for the fiscal year ended August 31, 2017. The Tenth Amendment is incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q for the fiscal quarter ended November 30, 2017. The Eleventh and Twelfth Amendments are incorporated by reference to Exhibits 10.1 and 10.2, respectively, to the Quarterly Report on Form 10-Q for the fiscal quarter ended May 31, 2018. The Thirteenth and Fourteenth Amendments are filed herewith.</p>
10.21	<p>Contract for Purchase and Sale of Real Estate, dated June 29, 2017, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by First Amendment to Contract for Purchase and Sale of Real Estate, dated August 28, 2017, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by Second Amendment to Contract for Purchase and Sale of Real Estate, dated September 15, 2017, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by Third Amendment to Contract for Purchase and Sale of Real Estate, dated September 28, 2017, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by Fourth Amendment to Contract for Purchase and Sale of Real Estate, dated October 9, 2017, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by Fifth Amendment to Contract for Purchase and Sale of Real Estate, dated October 18, 2017, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by Sixth Amendment to Contract for Purchase and Sale of Real Estate, dated October 20, 2017, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by Seventh Amendment to Contract for Purchase and Sale of Real Estate, dated October 31, 2017, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by Eighth Amendment to Contract for Purchase and Sale of Real Estate, dated November 3, 2017, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by Ninth Amendment to Contract for Purchase and Sale of Real Estate, dated November 7, 2017, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by <u>Tenth Amendment</u> to Contract for Purchase and Sale of Real Estate, dated November 10, 2017, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by <u>Eleventh Amendment</u> to Contract for Purchase and Sale of Real Estate, dated March 29, 2018, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by <u>Twelfth Amendment</u> to Contract for Purchase and Sale of Real Estate, dated January 22, 2019, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by <u>Thirteenth Amendment</u> to Contract for Purchase and Sale of Real Estate, dated April 18, 2019, by and between PCY Holdings, LLC and KB Home Colorado Inc., as amended by <u>Fourteenth Amendment</u> to Contract for Purchase and Sale of Real Estate, dated May 21, 2019, by and between PCY Holdings, LLC and KB Home Colorado Inc. The Contract for Purchase and Sale of Real Estate and the First through Ninth Amendments are incorporated by reference to Exhibit 10.21 to the Annual Report on Form 10-K for the fiscal year ended August 31, 2017. The Tenth Amendment is incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-Q for the fiscal quarter ended November 30, 2017. The Eleventh Amendment is incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q for the fiscal quarter ended May 31, 2019. The Twelfth Amendment is incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q for the fiscal quarter ended May 31, 2019. The Thirteenth Amendment is incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-Q for the fiscal quarter ended May 31, 2019. The Fourteenth Amendment is incorporated by reference to Exhibit 10.4 to the Quarterly Report on Form 10-Q for the fiscal quarter ended May 31, 2019</p>

<u>Exhibit Number</u>	<u>Description</u>
16.1	Letter of Crowe Horwath dated December 5, 2017. Incorporated by reference to Exhibit 16.1 to the Current Report on Form 8-K filed on December 6, 2017.
16.2	Letter of EKS&H LLLP, dated October 4, 2018. Incorporated by reference to Exhibit 16.1 to the Current Report on Form 8-K filed on October 4, 2018.
21.1	Subsidiaries *
23.1	Consent of Plante & Moran PLLC *
31.1	Certification under Section 302 of the Sarbanes-Oxley Act of 2002. *
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ***
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document. *
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document. *
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document. *
101.LAB	XBRL Taxonomy Extension Label Linkbase Document. *
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document. *

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\* Filed herewith

\*\* Indicates management contract or compensatory plan or arrangement in which directors or executive officers are eligible to participate.

\*\*\* Furnished herewith

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PURE CYCLE CORPORATION

/s/ Mark W. Harding

Mark W. Harding, President and Chief Financial Officer  
November 12, 2019

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Mark W. Harding</u> Mark W. Harding	President, Chief Financial Officer and Director (Principal Executive Officer, Principal Financial and Accounting Officer)	November 12, 2019
<u>/s/ Harrison H. Augur</u> Harrison H. Augur	Chairman, Director	November 12, 2019
<u>/s/ Patrick J. Beirne</u> Patrick J. Beirne	Director	November 12, 2019
<u>/s/ Arthur G. Epker III</u> Arthur G. Epker III	Director	November 12, 2019
<u>/s/ Richard L. Guido</u> Richard L. Guido	Director	November 12, 2019
<u>/s/ Peter C. Howell</u> Peter C. Howell	Director	November 12, 2019

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## DESCRIPTION OF CAPITAL STOCK

The following is a description of each class of securities of Pure Cycle Corporation (“Pure Cycle” or the “Company”) that is registered under Section 12 of the Securities Exchange Act of 1934, as amended, and does not purport to be complete. For a complete description of the terms and provisions of such securities, refer to our articles of incorporation and our bylaws, which are incorporated by reference herein to Appendix B and Appendix C, respectively, to the Company’s Proxy Statement on Schedule 14A filed on December 14, 2007, with the Securities and Exchange Commission. This summary is qualified in its entirety by reference to these documents.

Our authorized capital stock consists of:

- 40,000,000 shares of common stock, par value 1/3 of \$.01 per share, of which 23,826,598 shares were issued and outstanding as of November 8, 2019; and
- 25,000,000 shares of preferred stock, par value \$.001 per share, of which 432,513 shares of Series B Preferred Stock were issued and outstanding as of November 8, 2019.

### Common Stock

*Quorum and Voting Rights.* Each share of common stock is entitled to one vote in the election of directors and on all matters as to which holders of common stock are entitled to vote. Holders of not less than a majority of the shares entitled to vote at any meeting of shareholders constitute a quorum unless otherwise required by law. Except with respect to the election of directors or as otherwise required by law or the articles of incorporation, a proposal is approved if the number of votes cast in favor of the proposal exceeds the number of votes cast against the proposal. Meetings of our shareholders may be called on no fewer than 10 days nor more than 60 days’ notice.

*Election of Directors.* Directors hold office until the next annual meeting of shareholders. Directors are elected by a plurality of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors. Cumulative voting is not permitted.

*Dividend and Liquidation Rights.* Each share of common stock has an equal and ratable right to receive dividends when declared by our board of directors out of assets legally available for that purpose and subject to our dividend obligations to holders of any preferred stock then outstanding. We currently do not expect to pay any dividends on our common stock.

In the event of a liquidation, dissolution or winding up, the holders of our common stock are entitled to share equally and ratably in the assets available for distribution after payment of all liabilities, subject to any prior rights of any holders of preferred stock outstanding at that time.

*Preemptive, Conversion or Redemption Rights.* The holders of common stock have no preemptive, subscription, conversion or redemption rights, and are not subject to further calls or assessments.

*Other Provisions.* All outstanding shares of our common stock are, and all shares of common stock that may be issued under this prospectus will be, fully paid and non-assessable.

*Transfer Agent and Registrar.* The transfer agent and registrar for our common stock is Broadridge Corporate Issuer Solutions, Inc., Attn: IWS, 1155 Long Island Avenue, Edgewood, NY 11717, telephone: 1-877-830-4932.

### Preferred Stock

Our articles of incorporation authorize our board of directors to establish one or more series of preferred stock. With respect to any series of preferred stock, our board of directors is authorized to determine the preferences, limitations and relative rights of that series. The relevant prospectus supplement will describe the terms of any preferred stock offered. These terms may include:

- the aggregate number of shares offered and the offering price;
- the dividend rate of the series, the conditions and dates upon which such dividends will be payable, the relation which such dividends will bear to the dividends payable on any other class or classes of stock, and whether such dividends will be cumulative or noncumulative;
- whether and upon what terms the shares will be redeemable;
- the extent, if any, to which holders of shares of the series will have preemptive rights;
- the terms and amount of any sinking fund provided for the purchase or redemption of the shares of the series;
- whether or not the shares of the series will be convertible into or exchangeable for shares of any other class or classes of stock, and, if provision is made for conversion or exchange, the times, prices, rates, adjustments and other terms and conditions of such conversion or exchange;
- the voting rights, if any, to which the holders of shares of the series will be entitled;
- the restrictions, if any, on the issue or reissue of any additional shares of preferred stock of that series;
- the rights of the holders of the shares of the series upon the dissolution, liquidation, or winding up of the Company;
- any restriction on alienability of shares of the series, or any provision discriminating against any existing or prospective holder of such shares as a result of such holder owning a substantial amount of shares of such series;
- any restriction on the repurchase or redemption of shares by us while there is any arrearage in the payment of dividends or sinking fund installments; and
- any other preferences, privileges and powers and relative, participating, optional or other special rights and qualifications, limitations or restrictions of such series, as the board of directors may deem advisable and as shall not be inconsistent with the provisions of the articles of incorporation and permitted by the laws of the State of Colorado.

Because the board of directors has the power to determine the preferences, limitations and relative rights of each series of preferred stock, it may provide the holders of any series of preferred stock with rights senior to the rights of the holders of the common stock.

### **Series B Preferred Stock**

The rights of our Series B Preferred Stock are tied to certain water rights we own. We own or control approximately 26,985 acre feet of tributary surface water, non-tributary groundwater and not non-tributary groundwater, and approximately 26,000 acre feet of adjudicated reservoir sites that we refer to as our “Rangeview Water Supply.” This water is located at the “Lowry Range,” which is owned by the Colorado State Board of Land Commissioners (the “Land Board”). Of the total water comprising our Rangeview Water Supply, we own 11,650 acre feet of water 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”), 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.

*Liquidation Rights.* Upon any voluntary or involuntary liquidation, dissolution or winding up of Pure Cycle, the holders of shares of Series B Preferred Stock will be entitled to be paid, before any distribution or payment is made upon any other equity securities of Pure Cycle, \$1.00 per share less an amount equal to all dividends paid thereon.

*Dividends.* Holders of the Series B Preferred Stock are entitled to receive dividends, when and as declared by our board of directors, in a total amount of \$1.00 per share. The Series B Preferred Stock will only earn and accrue dividends when we receive proceeds from the marketing, sale or other disposition of the Export Water or our interest

in the Export Water in an amount greater than \$36,026,232. Dividends are required to be paid when we receive such proceeds. Until all accrued dividends on the Series B Preferred Stock have been paid, we may not declare or pay dividends on the common stock.

*Redemption.* The Series B Preferred Stock is redeemable for cash at our option at a redemption price equal to \$1.00 per share less an amount equal to all dividends paid thereon. The Series B Preferred Stock may not be redeemed using proceeds from the sale of Export Water unless it would be permissible under the articles of incorporation to use such assets to pay a dividend on the Series B Preferred Stock. We may redeem the Series B Preferred Stock in lieu of payment of dividends thereon. Holders of Series B Preferred Stock do not have any right to require us to redeem any or all shares of the Series B Preferred Stock.

*Voting Rights.* Holders of Series B Preferred Stock generally will have no voting rights except as required by law. Certain changes to the terms of the Series B Preferred Stock that would be materially adverse to the rights of holders of the Series B Preferred Stock cannot be made without the approval of the holders of a at least 66-2/3% of the outstanding Series B Preferred Stock voting separately as a class. These changes requiring approval consist of the following:

- altering or changing terms, preferences or privileges of Series B Preferred Stock; and
- authorizing a new security ranking senior to the Series B Preferred Stock as to dividend or liquidation rights.

In addition, when dividends on the Series B Preferred Stock have accrued but have not been declared by our board of directors, the holders of the Series B Preferred Stock will be entitled to vote with the holders of common stock at any meeting of shareholders held during the period such dividends remain in arrears. Each share of Series B Preferred Stock will have one vote when voting with the common stock.

## **Anti-Takeover Provisions of Governing Documents**

Our bylaws require that shareholders give advance notice of proposals to be presented at meetings of shareholders, including director nominations. The date by which notice must be given to be considered timely is set forth in our most recent definitive proxy statement filed with the Securities and Exchange Commission.

Our board of directors can at any time under our articles of incorporation and without shareholder approval issue one or more new series of preferred stock. In some cases, the issuance of preferred stock without shareholder approval could discourage or make more difficult attempts to take control of Pure Cycle through a merger, tender offer, proxy contest or otherwise. Preferred stock with special voting rights or other features issued to persons favoring management could stop a takeover by preventing the person trying to take control of our company from acquiring the voting shares necessary to take control.



**SUBSIDIARIES**

PCY Holdings, LLC, a Colorado limited liability company  
PCY-DT, LLC, a Colorado limited liability company

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements on Forms S-8 (Registration Nos. 333-115240 and 333-195733) of Pure Cycle Corporation of our report dated November 12, 2019, on the consolidated financial statements of Pure Cycle Corporation as of and for the year ended August 31, 2019, and our report dated November 12, 2019, on internal control over financial reporting as of August 31, 2019, of Pure Cycle Corporation.

/s/ Plante & Moran PLLC

Boulder, Colorado  
November 12, 2019

**CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Mark W. Harding, certify that:

1. I have reviewed this Annual Report on Form 10-K of Pure Cycle Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 12, 2019

/s/ MARK W. HARDING

Mark W. Harding  
Principal Executive Officer and Principal Financial  
Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Mark W. Harding, the Chief Executive Officer and Chief Financial Officer of Pure Cycle Corporation (the “Company”), hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that::

1. The Form 10-K of the Company for the fiscal year ended August 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ MARK W. HARDING

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Mark W. Harding  
Principal Executive Officer and Principal Financial Officer  
November 12, 2019

**PURE CYCLE CORPORATION**  
**34501 E. Quincy Avenue**  
**Bldg. 34, Box 10**  
**Watkins, CO 80137**  
**(303) 292-3456**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**  
**To be held on January 15, 2020**

TO PURE CYCLE'S SHAREHOLDERS:

You are cordially invited to attend the annual meeting of shareholders of Pure Cycle Corporation (the "Company"). The meeting will be held at 1550 Seventeenth Street, Suite 500, Denver, Colorado 80202, at the offices of Davis Graham & Stubbs LLP, on January 15, 2020 at 2:00 p.m. Mountain Time. The purposes of the meeting are to:

1. Elect a board of six directors to serve until the next annual meeting of shareholders, or until their successors have been duly elected and qualified;
2. Ratify the appointment of Plante & Moran PLLC as the Company's independent registered public accounting firm for the 2020 fiscal year;
3. Approve, on an advisory basis, the compensation of the Company's named executive officer;
4. Vote, on an advisory basis, on the frequency of future advisory votes on executive compensation; and
5. Transact such other business as may properly come before the meeting or any adjournment(s) or postponement(s) thereof.

Only shareholders of record as of 5:00 p.m. Mountain Time on November 18, 2019, will be entitled to notice of or to vote at this meeting or any adjournment(s) or postponement(s) thereof.

**Whether or not you plan to attend, please vote promptly by following the instructions on the Important Notice Regarding the Availability of Proxy Materials or, if you requested a printed set of proxy materials, by completing, signing and dating the enclosed proxy and returning it in the accompanying postage-paid envelope. Shareholders who attend the meeting may revoke their proxies and vote in person if they so desire.**

BY ORDER OF THE BOARD OF DIRECTORS

/s/ Mark W. Harding

\_\_\_\_\_  
Mark W. Harding, President

December 5, 2019

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**PURE CYCLE CORPORATION**  
**34501 E. Quincy Avenue**  
**Bldg. 34, Box 10**  
**Watkins, CO 80137**  
**(303) 292-3456**

**PROXY STATEMENT FOR THE**  
**ANNUAL MEETING OF SHAREHOLDERS**  
**To be held on January 15, 2020**

This proxy statement is being made available to shareholders in connection with the solicitation of proxies by the board of directors of PURE CYCLE CORPORATION (the “Company,” “we” or “our”) to be voted at the annual meeting of shareholders of the Company (the “Meeting”) to be held at 1550 Seventeenth Street, Suite 500, Denver, Colorado 80202, at the offices of Davis Graham & Stubbs LLP on January 15, 2020, at 2:00 p.m. Mountain Time, or at any adjournment or postponement thereof. This proxy statement will be made available to shareholders on or about December 5, 2019. The cost of soliciting proxies is being paid by the Company. The Company’s officers, directors, and other regular employees may, without additional compensation, solicit proxies personally or by other appropriate means.

Pursuant to rules adopted by the Securities and Exchange Commission (“SEC”), the Company has elected to provide access to its proxy materials via the Internet. Accordingly, we are sending a Notice of Internet Availability of Proxy Materials (the “Notice”) to our shareholders, who will have the ability to access the proxy materials on the website referred to in the Notice or to request a printed set of the proxy materials. Instructions on how to access the proxy materials over the Internet or to request a printed copy can be found in the Notice. In addition, shareholders may request proxy materials in printed form by writing to the Company’s Secretary at the Company’s address set forth above.

If you would like to receive the Notice via email rather than regular mail in future years, please follow the instructions in the Notice. Choosing to receive future notices by email will help the Company reduce the costs and environmental impact of the Company’s shareholder meetings.

**ABOUT THE MEETING**

**Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting of Shareholders to be Held on January 15, 2020:**

**The proxy materials, including this proxy statement and the Company’s Annual Report on Form 10-K for the fiscal year ended August 31, 2019, are available at <http://www.proxyvote.com>.**

***What is the purpose of the Meeting?***

At the Meeting, shareholders are asked to act upon the matters outlined above in the Notice of Annual Meeting of Shareholders and as described in this proxy statement. The matters to be considered are (1) the election of directors, (2) the ratification of the appointment of the Company’s independent registered public accounting firm for the fiscal year ending August 31, 2020, (3) the approval, on an advisory basis, of the compensation of the Company’s named executive officer, (4) the recommendation, by advisory vote, on the frequency of advisory voting on executive compensation, and (5) such other matters as may properly come before the Meeting. Management will be available to respond to appropriate questions.

***Who is entitled to vote and how many votes do I have?***

If you were a shareholder of record as of 5:00 p.m. Mountain Time on November 18, 2019, you will be entitled to vote at the Meeting or any adjournments or postponements thereof. On November 8, 2019, there were 23,826,598 shares of the Company’s 1/3 of \$.01 par value common stock (“common stock”) issued and outstanding. Each outstanding share of the Company’s common stock will be entitled to one vote on each matter acted upon. There is no cumulative voting.

***How do I vote?***

If your shares are held in an account at a bank, brokerage firm, or other nominee in “street name,” you need to submit voting instructions to your bank, brokerage firm, or other nominee in order to cast your vote. If you wish to vote in person at the Meeting, you must obtain a valid proxy from the nominee that holds your shares. If you are the

shareholder of record, you may vote your shares by following the instructions in the Notice mailed on or about December 5, 2019, or, if you have received a printed set of the proxy materials, you may vote your shares by completing, signing and dating the enclosed proxy card and then mailing it to the Company's transfer agent in the pre-addressed envelope provided. You may also vote your shares by calling the transfer agent at the number listed on the proxy card or by attending the Meeting in person.

***Can I change or revoke my vote?***

A proxy may be revoked by a shareholder any time before it is voted at the Meeting by submission of another proxy bearing a later date, by attending the Meeting and voting in person, or if you are a shareholder of record, by written notice of revocation to the Secretary of the Company.

***Is my vote confidential?***

Proxy instructions, ballots and voting tabulations that identify individual shareholders are handled in a manner that protects your voting privacy. Your vote will not be disclosed within the Company or to third parties, except (1) as necessary to meet applicable legal requirements, (2) to allow for the tabulation of votes and certification of the vote, and (3) to facilitate a successful proxy solicitation. Occasionally, shareholders provide written comments on their proxy cards, which are forwarded to management of the Company.

***Will my shares held in street name be voted if I do not provide my proxy?***

If you hold your shares through a bank, broker, or other nominee, your shares must be voted by the nominee. If you do not provide voting instructions, under the rules of the securities exchanges, the nominee's discretionary authority to vote your shares is limited to "routine" matters. Proposals 1, 3 and 4 are not considered routine matters for this purpose, so if you do not provide your proxy, your shares will not be voted at the Meeting with respect to these proposals. In this case, your shares will be treated as "broker non-votes" and will not be counted for purposes of determining the vote on these proposals.

A "broker non-vote" occurs when a nominee holding shares for a beneficial owner has discretionary authority to vote on at least one matter at the meeting but does not vote on a particular proposal because the nominee does not have discretionary voting power with respect to that proposal and has not received voting instructions from the beneficial owner.

***What is a quorum?***

The presence, in person or by proxy, of the holders of a majority of the outstanding shares of common stock constitutes a quorum at the Meeting for the election of directors and for the other proposals. Abstentions and broker non-votes are counted for the purposes of determining whether a quorum is present at the Meeting.

***How many votes are required to approve the proposals?***

- *Election of Directors* – The election of directors requires the affirmative vote of a plurality of the votes cast by shares represented in person or by proxy and entitled to vote for the election of directors. This means that the nominees receiving the most votes from those eligible to vote will be elected. You may vote "FOR" all of the nominees or your vote may be "WITHHELD" with respect to one or more of the nominees; however, a "withheld" vote or a broker non-vote (defined above) will have no effect on the outcome of the election.
- *Ratification of auditors, advisory vote on executive compensation, and other matters* – The number of votes cast in favor of the proposal at the Meeting must exceed the number of votes cast against the proposal for the approval of Proposals 2, 3 and other matters. For Proposals 2, 3 and any other business matters to be voted on, you may vote "FOR," "AGAINST," or you may "ABSTAIN." Abstentions and broker non-votes will not be counted as votes for or against a proposal and, therefore, have no effect on the vote. Because your vote on executive compensation is advisory, it will not be binding on the board of directors or the Company. However, the board of directors will review the voting results and take them into consideration when making future decisions regarding executive compensation.



- *Frequency on advisory vote on executive compensation* – With respect to the advisory vote regarding the frequency of future executive compensation advisory votes, shareholders may vote for a frequency of every one, two, or three years, or may abstain. The board of directors will consider the option that receives the most votes to be the option selected by our shareholders. Although the vote is advisory and not binding, the board of directors will review and consider the voting results when determining the frequency of shareholder voting on executive compensation. Abstentions and “broker non-votes” will be excluded from the vote and will have no effect on the outcome of the vote.

If no specification is made, then the shares will be voted “FOR” the election as directors of the persons nominated by the board of directors, “FOR” Proposal 2, “FOR” Proposal 3, for once every THREE years with respect to Proposal 4, and otherwise in accordance with the recommendations of the board of directors.

***Does the Company expect there to be any additional matters presented at the Meeting?***

Other than the items of business described in this proxy statement, the Company is not aware of any other business to be acted upon at the Meeting. If you grant a proxy, the persons named as proxy holders, Mark W. Harding and Harrison H. Augur, have the discretion to vote your shares on any additional matter properly presented for a vote at the Meeting. If for any unforeseen reason any of the director nominees are not available for election at the date of the Meeting, the named proxy holders will vote your shares for such other candidates as may be nominated by the board.

***When will the results of the voting being announced?***

The Company will announce preliminary results at the Meeting and will publish final results in a current report on Form 8-K to be filed within four business days of the date of the Meeting.

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND  
MANAGEMENT AND RELATED SHAREHOLDER MATTERS**

**Voting Securities and Principal Holders Thereof**

The following table sets forth information as of November 18, 2019, as to the beneficial ownership of shares of the Company's common stock by (i) each person (or group of affiliated persons) known to the Company to own beneficially 5% or more of the common stock, (ii) each director of the Company and each nominee for director, (iii) each executive officer, and (iv) all directors and executive officers as a group. All information is based on information filed by such persons with the SEC and other information provided by such persons to the Company. Except as otherwise indicated, the Company believes that each of the beneficial owners listed has sole investment and voting power with respect to such shares. On November 18, 2019, there were 23,826,598 common shares outstanding. Shares not outstanding but deemed beneficially owned by virtue of the right of a person to acquire shares within 60 days of November 18, 2019, are included as outstanding and beneficially owned for that person but are not treated as outstanding for the purpose of computing the percentage ownership of any other person.

<u>Name and address of beneficial owner</u>	<u>Amount and nature of beneficial ownership</u>	<u>Percent of class</u>
Mark W. Harding**	927,244 <sup>(1)</sup>	3.86%
Harrison H. Augur**	166,281 <sup>(2)</sup>	*
Patrick J. Beirne**	29,500 <sup>(3)</sup>	*
Arthur G. Epker III**	58,000 <sup>(4)</sup>	*
Richard L. Guido**	58,000 <sup>(5)</sup>	*
Peter C. Howell**	58,500 <sup>(6)</sup>	*
<b>All officers and directors as a group (6 persons)</b>	<b>1,297,525<sup>(7)</sup></b>	<b>5.35%</b>
PAR Capital Management, Inc. / PAR Investment Partners, L.P. / PAR Group II, L.P.	3,032,970 <sup>(8)</sup>	12.73%
Plaisance Capital LLC / Plaisance SPV I, LLC / Daniel Kozlowski 250 Fillmore Street, Suite 525, Denver, CO 80206	3,754,609 <sup>(9)</sup>	15.76
Trigran Investments, Inc. 630 Dundee Road, Suite 230, Northbrook, IL 60062	1,806,463 <sup>(10)</sup>	7.58%

\* Less than 1%

\*\* Address is the Company's address: 34501 E. Quincy Avenue, Bldg. 34, Box 10, Watkins, CO 80137

- (1) Includes 200,001 shares purchasable by Mr. Harding under options exercisable within 60 days. Includes 210,000 shares of common stock held by SMA Investments, LLLP, a limited liability limited partnership controlled by Mr. Harding.
- (2) Includes 53,000 shares purchasable by Mr. Augur under options exercisable within 60 days. Includes 10,000 shares of common stock held by Patience Partners, LLC, a limited liability company in which a foundation controlled by Mr. Augur is a 60% member and Mr. Augur is a 20% managing member. Includes 46,111 shares of common stock held in a margin account owned by Auginco, a Colorado general partnership, which is owned 50% by Mr. Augur and 50% by his wife.
- (3) Includes 29,500 shares purchasable by Mr. Beirne under options exercisable within 60 days.
- (4) Includes 53,000 shares purchasable by Mr. Epker under options exercisable within 60 days.
- (5) Includes 53,000 shares purchasable by Mr. Guido under options exercisable within 60 days.
- (6) Includes 50,500 shares purchasable by Mr. Howell under options exercisable within 60 days.
- (7) Includes the following shares:
  - a. 210,000 shares held by SMA Investments, LLLP as described in number 1 above,
  - b. 439,001 shares purchasable by directors and officers under options exercisable within 60 days, and
  - c. 10,000 shares of common stock held by Patience Partners, LLC, and 46,111 shares of common stock held by Auginco, as described in number 2 above.
- (8) PAR Investment Partners, L.P. ("PIP") owns directly 3,032,970 shares. PAR Group II, L.P. ("PGII"), through its control of PIP as general partner, has sole voting and dispositive power with respect to all 3,032,970 shares owned beneficially by PIP. PAR Capital Management, Inc., through its control of PGII as general partner, has sole voting and dispositive power with respect to all 3,032,970 shares owned beneficially by PIP.
- (9) This disclosure is based on the Schedule 13D filed by Plaisance Capital LLC ("PCL"), Plaisance SPV I, LLC ("PSPV"), and Daniel Kozlowski on October 15, 2019. It includes 3,754,609 shares of common stock owned by PCL. Daniel Kozlowski, as managing member of PCL, may be considered the beneficial owner of shares beneficially owned by PCL. PSVP, through PCL as its investment manager, may be considered the beneficial owner of 2,684,097 shares owned by PCL.
- (10) This disclosure is based on a Schedule 13G/A filed by Trigran Investments, Inc. ("TII"), Douglas Granat, Lawrence A. Oberman, Steven G. Simon, Bradley F. Simon and Steven R. Monieson on February 14, 2019. It includes 1,806,463 shares of common stock owned by TII. By reason of their roles as controlling shareholders and/or sole directors of TII, each of Douglas Granat, Lawrence A. Oberman, Steven G. Simon, Bradley F. Simon and Steven R. Monieson may be considered the beneficial owners of shares beneficially owned by TII.

## Securities Authorized for Issuance Under Equity Compensation Plans

The following table sets forth certain information regarding the Company's equity compensation plans as of August 31, 2019. All securities outstanding represent options to purchase common stock.

Plan category	Number of securities to be issued upon exercise of outstanding options (a)	Weighted-average exercise price of outstanding options (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans:			
Approved by security holders . . . . .	555,500	\$6.33	1,230,500
Not approved by security holders . . . . .	<u>—</u>	<u>—</u>	<u>—</u>
<b>Total</b> . . . . .	<b><u>555,500</u></b>	<b><u>\$6.33</u></b>	<b><u>1,230,500</u></b>

## DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth the Company's directors, director nominees, and executive officer and their positions currently held with the Company.

Name	Age	Position
Harrison H. Augur . . . . .	77	Chairman of the Board*
Patrick J. Beirne . . . . .	56	Director*
Arthur G. Epker, III . . . . .	57	Director*
Richard L. Guido . . . . .	75	Director*
Mark W. Harding . . . . .	56	Director, President, CEO and CFO*
Peter C. Howell . . . . .	70	Director*

\* Director nominee

The principal occupation and other information about each of the individuals listed above, including the period during which each has served as director or officer, can be found beginning on page 14.

## CORPORATE GOVERNANCE AND BOARD MATTERS

### **Board Leadership Structure**

The Company's board of directors has chosen to separate the positions of Chief Executive Officer ("CEO") and Chairman of the Board. Keeping these positions separate allows the Company's CEO to focus on developing and implementing the Company's business plans and supervising the Company's day-to-day operations and allows the Company's Chairman to lead the board of directors in its oversight and advisory roles. Because of the many responsibilities of the board of directors and the significant time and effort required by each of the Chairman and the CEO to perform their respective duties, the Company believes that having separate persons in these roles enhances the ability of each to discharge those duties effectively and, as a corollary, enhances the Company's prospects for success. The board of directors also believes that having separate positions provides a clear delineation of responsibilities for each position and fosters greater accountability of management.

### **Board Risk and Oversight**

Our board of directors, as a whole and through its committees, has responsibility for the oversight of risk management. With the oversight of the Company's full board of directors, the Company's CEO is responsible for the day-to-day management of the material risks the Company faces. In its oversight role, the board of directors has the responsibility to satisfy itself that the risk management processes designed and implemented by management are adequate and functioning as designed. At least annually, the board of directors holds a strategic planning session with management to discuss strategies, key challenges, risks and opportunities for the Company. This involvement of the board of directors in setting the Company's business strategy is a key part of its oversight of risk management, its assessment of management's appetite for risk, and its determination of what constitutes an appropriate level of risk for the Company. Additionally, the board of directors regularly receives updates from management regarding certain risks that the Company faces, including various operating risks. Management attends meetings of the board of directors and its committees on a regular basis, and as is otherwise needed, and is available to address any questions or concerns raised by the board on risk management and any other matters.

The Audit Committee is responsible for overseeing risk management of financial matters, financial reporting, the adequacy of the Company's risk-related internal controls, internal investigations, and enterprise risks, generally. The Nominating and Corporate Governance Committee (the "Nominating Committee") oversees the Company's Corporate Governance Guidelines and governance-related risks, such as board independence, as well as management and director succession planning. The Compensation Committee oversees risks related to compensation policies and practices and is responsible for establishing and maintaining compensation policies and programs designed to create incentives consistent with the Company's business strategy that do not encourage excessive risk-taking.

### **Board Membership and Director Independence**

**Director Independence** – At least a majority of the members of the board and all members of the board's Audit, Compensation, and Nominating Committees must be independent in accordance with the listing standards of The NASDAQ Stock Market. The board has determined that four of the six current members, Messrs. Augur, Epker, Guido, and Howell, are independent pursuant to the standards of The NASDAQ Stock Market.

**Terms of Directors and Officers** – All directors are elected for one-year terms which expire at the annual meeting of shareholders or when their successors are duly elected and qualified. The Company's officers are elected annually by the board of directors and hold office until their successors are duly elected and qualified.

**Family Relationships of Directors and Officers** – None of the current directors or officers, or nominees for director, is related to any other officer or director of the Company or to any nominee for director.

**Board Meetings Held** – The board of directors and each of the standing committees described below meet throughout the fiscal year on a set schedule. They also hold special meetings and act by written consent from time to time as appropriate. The Company's independent directors meet regularly in executive sessions without management present. Generally, the executive sessions of independent directors are held in conjunction with each regularly scheduled board meeting.

During the fiscal year ended August 31, 2019, the board of directors held six (6) meetings. All board members attended 75% or more of the aggregate of the total number of meetings of the board of directors and the total number of meetings held by all committees of the board on which the director served during the periods that the director served on the board and committees, as applicable. All of the Company’s board members are expected to attend the annual meeting of shareholders. All of the Company’s board members attended the 2019 annual meeting of shareholders.

## Committees

The Board has three standing committees: the Audit Committee, Compensation Committee and Nominating Committee. Each of the committees regularly reports on its activities and actions to the full board of directors.

Membership in the standing committees for fiscal 2019 is set forth below:

<b>Fiscal 2019 Committee Membership</b>			
<b>Director</b>	<b>Audit Committee</b>	<b>Compensation Committee</b>	<b>Nominating Committee</b>
H. Augur .....	X	X	X
P. Beirne.....	—	—	—
A. Epker.....	—	Chair	X
R. Guido.....	X	X	Chair
M. Harding.....	—	—	—
P. Howell.....	Chair	—	—

**Audit Committee** – The Audit Committee consists of Mr. Howell (Chairman) and Messrs. Augur and Guido. The board of directors has determined that all of the members of the Audit Committee are “independent” within the meaning of the listing standards of The NASDAQ Stock Market and the SEC rules governing audit committees. In addition, the board has determined that Mr. Howell meets the SEC criteria of an “audit committee financial expert” by reason of his understanding of Accounting Principles Generally Accepted in the United States of America (“GAAP”) and the application of GAAP, his education, his experiences as an auditor and chief financial officer, and his understanding of financial statements. See Mr. Howell’s biography under *Election of Directors (Proposal No. 1)* for additional information. The functions to be performed by the Audit Committee include the appointment, retention, compensation and oversight of the Company’s independent auditors, including pre-approval of all audit and non-audit services to be performed by such auditors. The Audit Committee Charter is available on the Company’s website at [www.purecyclewater.com](http://www.purecyclewater.com). The Audit Committee held nine (9) meetings during the fiscal year ended August 31, 2019.

**Compensation Committee** – The Compensation Committee consists of Mr. Epker (Chairman) and Messrs. Augur and Guido. The board of directors determined that all members of the Compensation Committee were “independent” within the meaning of the listing standards of The NASDAQ Stock Market. The functions to be performed by the Compensation Committee include establishing the compensation of officers, evaluating the performance of officers and key employees, and administering employee incentive compensation plans. The Compensation Committee typically meets with the CEO to obtain information about employee performance and compensation recommendations. It also has the authority to engage outside advisors to assist the committee with its functions. The Compensation Committee has the power to delegate authority to the CEO or a subcommittee to make certain determinations with respect to compensation for employees who are not executive officers. The Company’s Compensation Committee Charter is available on the Company’s website at [www.purecyclewater.com](http://www.purecyclewater.com). The Compensation Committee held three (3) meetings during the fiscal year ended August 31, 2019.

**Nominating and Corporate Governance Committee** – The Nominating Committee consists of Messrs. Guido (Chairman), Augur and Epker. The board of directors determined that all members of the Nominating Committee were “independent” within the meaning of the listing standards of The NASDAQ Stock Market. The principal responsibilities of the Nominating Committee are to identify and nominate qualified individuals to serve as members of the board and to make recommendations to the board with respect to director compensation. In addition, the Nominating Committee is responsible for establishing the Company’s Corporate Governance Guidelines and evaluating the board and its processes. In selecting nominees for the board, the Nominating Committee is seeking a board with a variety of experience and expertise, and in selecting nominees it will consider business experience in the industry in which the Company operates, financial expertise, independence from the Company, experience with publicly traded companies, experience with relevant regulatory matters in which the Company is involved, and a

reputation for integrity and professionalism. The Company does not have a formal policy with respect to the consideration of diversity in identifying director nominees, but it considers diversity as part of its overall assessment of the board's functions and needs. Nominees must be at least 21 years of age and less than 75 on the date of the annual meeting of shareholders unless the Nominating Committee waives such requirements. Identification of prospective board members is done by a combination of methods, including word-of-mouth in industry circles, inquiries of outside professionals and recommendations made to the Company. The Nominating Committee Charter is available on the Company's website at [www.purecyclewater.com](http://www.purecyclewater.com). The Nominating Committee held three (3) meetings during the fiscal year ended August 31, 2019.

The Nominating Committee will consider nominations for director made by shareholders of record entitled to vote. In order to make a nomination for election at the January 2021 annual meeting, a shareholder must provide notice, along with supporting information (discussed below) regarding such nominee, to the Company's Secretary by August 7, 2020, but not before June 8, 2020, in accordance with the Company's bylaws. The Nominating Committee evaluates nominees recommended by shareholders utilizing the same criteria it uses for other nominees. Each shareholder recommendation should be accompanied by the following:

- The full name, address, and telephone number of the person making the recommendation, and a statement that the person making the recommendation is a shareholder of record (or, if the person is a beneficial owner of the Company's shares but not a record holder, a statement from the record holder of the shares verifying the number of shares beneficially owned), and a statement as to whether the person making the recommendation has a good faith intention to continue to hold those shares through the date of the Company's next annual meeting of shareholders;
- The full name, address, and telephone number of the candidate being recommended, information regarding the candidate's beneficial ownership of the Company's equity securities, any business or personal relationship between the candidate and the person making the recommendation, and an explanation of the value or benefit the person making the recommendation believes the candidate would provide as a director;
- A statement signed by the candidate that he or she is aware of and consents to being recommended to the Nominating Committee and will provide such information as the Nominating Committee may request for its evaluation of candidates;
- A description of the candidate's current principal occupation, business or professional experience, previous employment history, educational background, and any areas of particular expertise;
- Information about any business or personal relationships between the candidate and any of the Company's customers, suppliers, vendors, competitors, directors or officers, or other persons with any special interest regarding any transactions between the candidate and the Company; and
- Any information in addition to the above about the candidate that would be required to be included in the Company's proxy statement (including without limitation information about legal proceedings in which the candidate has been involved within the past ten years).

### **Code of Business Conduct and Ethics**

The Company has adopted a Code of Business Conduct and Ethics for its directors, officers and employees, which is available on the Company's website at [www.purecyclewater.com](http://www.purecyclewater.com).

### **Shareholder Communications with the Board**

The board of directors has adopted a policy for shareholders to send communications to the board. The policy is available on the Company's website. Shareholders wishing to send communications to the board may contact the Chairman of the board at the Company's principal place of business or email [chairman@purecyclewater.com](mailto:chairman@purecyclewater.com). All such communications shall be shared with the members of the board, or if applicable, a specified committee or director.

### **Director Compensation**

Directors who are employees of the Company receive no fees for board service. Currently, Mr. Harding is the only director who is also an employee. Each non-employee director receives a payment of \$12,000 for each full year in which he or she serves as a director, with an additional payment of \$3,500 for serving as chairman of a committee,



\$1,000 for each committee on which he or she serves as a member but not as chairman, and \$1,000 for serving as chairman of the board. Each director receives \$1,000 for attendance at each board meeting and, if committee meetings are held separately from board meetings, each director receives \$1,000 for attendance at such committee meetings.

The following table sets forth summary information concerning the compensation paid to the Company's non-employee directors in fiscal 2019 for services to the Company:

<b>Director Compensation</b>			
<b>Name</b>	<b>Fees Earned or Paid in Cash (\$)</b>	<b>Option Awards<sup>(1)</sup> (\$)</b>	<b>Total (\$)</b>
H. Augur <sup>(2)</sup> .....	26,000	25,348	51,348
P. Beirne <sup>(3)</sup> .....	18,000	25,348	43,348
A. Epker <sup>(4)</sup> .....	22,500	25,348	47,848
R. Guido <sup>(5)</sup> .....	27,500	25,348	52,848
P. Howell <sup>(6)</sup> .....	25,500	25,348	50,848

- (1) In addition to cash compensation, pursuant to the Pure Cycle Corporation 2014 Equity Incentive Plan effective as of April 12, 2014 (the "2014 Plan"), each non-employee director may receive an option to purchase shares of common stock at the discretion of the board, and the terms of such awards granted to non-employee directors, including the discretion to adopt one or more formulas for the determination of non-employee director awards, are at the discretion of the board. On January 14, 2015, the board adopted a formula under the 2014 Plan that provides for an option grant to each non-employee director to purchase 6,500 shares of common stock at each annual meeting of shareholders at which the non-employee director is re-elected to the board. The options vest on the date of the next annual meeting of shareholders or the first anniversary of the date of grant, whichever is earlier. On January 27, 2016, the board adopted a formula under the 2014 Plan providing for an option grant to each non-employee director to purchase 10,000 shares of common stock upon initial election or appointment to the board, which vests one-half on each of the first two anniversary dates of the grant. The option exercise price for all non-employee director grants is set at the fair market value of the common stock on the date of the grant. The amounts in this column represent the aggregate grant date fair value of options granted during the Company's fiscal year ended August 31, 2019, as computed in accordance with FASB ASC Topic 718. For more information about how the Company values and accounts for share-based compensation see *Note 8 – Shareholders' Equity* to the Company's audited consolidated financial statements for the year ended August 31, 2019, which are included in the Company's 2019 Annual Report on Form 10-K.
- (2) The \$26,000 earned by Mr. Augur is comprised of \$12,000 for serving on the board, \$1,000 for being chairman of the board, \$3,000 for serving on three committees, and \$10,000 for attendance at board and committee meetings. Mr. Augur had options outstanding to purchase 53,000 shares of common stock as of August 31, 2019, all of which are exercisable within 60 days of the filing of this proxy statement.
- (3) The \$18,000 earned by Mr. Beirne is comprised of \$12,000 for serving on the board and \$6,000 for attendance at board meetings. Mr. Beirne had options outstanding to purchase 29,500 shares of common stock as of August 31, 2019, all of which are exercisable within 60 days of the filing of this proxy statement.
- (4) The \$22,500 earned by Mr. Epker is comprised of \$12,000 for serving on the board, \$3,500 for serving as chairman of the Compensation Committee, \$1,000 for serving on one additional committee, and \$6,000 for attendance at board and committee meetings. Mr. Epker had options outstanding to purchase 53,000 shares of common stock as of August 31, 2019, all of which are exercisable within 60 days of the filing of this proxy statement.
- (5) The \$27,500 earned by Mr. Guido is comprised of \$12,000 for serving on the board, \$3,500 for serving as chairman of the Nominating Committee, \$2,000 for serving on two additional committees, and \$10,000 for attendance at board and committee meetings. Mr. Guido had options outstanding to purchase 53,000 shares of common stock as of August 31, 2019, all of which are exercisable within 60 days of the filing of this proxy statement.
- (6) The \$25,500 earned by Mr. Howell is comprised of \$12,000 for serving on the board, \$3,500 for serving as chairman of the Audit Committee, and \$10,000 for attendance at board and committee meetings. Mr. Howell had options outstanding to purchase 50,500 shares of common stock as of August 31, 2019, all of which are exercisable within 60 days of the filing of this proxy statement.

## EXECUTIVE COMPENSATION

### Executive Compensation Discussion

#### *Person Covered*

This discussion addresses compensation for fiscal 2019 for Mark W. Harding, the Company's President, CEO and Chief Financial Officer ("CFO") and its only executive officer.

#### *Compensation Philosophy*

The Company's executive compensation program is administered by the Compensation Committee of the board of directors. The Compensation Committee reviews the performance and compensation level for the CEO and makes recommendations to the board of directors for final approval. The Compensation Committee also determines equity grants under the 2014 Plan, if any. The CEO may provide information to the Compensation Committee regarding his compensation; however, the Compensation Committee makes the final determination on the executive compensation recommendation to the board. Final compensation determinations are generally made in September immediately following the end of the Company's fiscal year. The following outlines the philosophy and objectives of the Company's compensation plan.

The objectives of the Company's compensation plan are to correlate executive compensation with the Company's objectives and overall performance and to enable the Company to attract, retain and reward executive officers who contribute to its long-term growth and success. The compensation plan is designed to create a mutuality of interest between executive and shareholders through equity ownership programs and to focus the executive's attention on overall corporate objectives, in addition to the executive's personal objectives.

The goal of the Compensation Committee is to provide a compensation package that is competitive with compensation practices of companies with which the Company competes, provides variable compensation that is linked to achievement of the Company's operational performance goals, and aligns the interests of the executive officer and employees with those of the shareholders of the Company. Additionally, the Compensation Committee's goal is to design a compensation package that falls within the mid-range of the packages provided to executives of similarly sized corporations in like industries.

Generally, the executive officer receives a base salary and an opportunity to earn a cash bonus based on attainment of predetermined objectives at the discretion of the Compensation Committee. Long-term equity incentives are also considered. The mixture of cash and non-cash compensation items is designed to provide the executive with a competitive total compensation package while not using an excessive amount of the Company's cash or overly diluting the equity positions of its shareholders. The Company's executive officer does not receive any perquisites or personal benefits. The executive officer is eligible for the same benefits available to all Company employees. Currently, this includes participation in a tax-qualified 401(k) plan and health and dental plans.

#### *Compensation Consultants*

The Compensation Committee charter authorizes the Compensation Committee to engage compensation consultants and other advisors to assist it with its duties. No compensation consultants were engaged by either management or the Compensation Committee during fiscal 2019.

#### *Shareholder Feedback and Say-On-Pay Results*

The Compensation Committee considers the outcome of shareholder advisory votes on executive compensation when making future decisions relating to the compensation of the CEO and the Company's executive compensation program. At the 2019 annual meeting of shareholders, approximately 99.4% of the votes cast were for approval of the "say-on-pay" proposal. The Compensation Committee believes the results conveyed support for continuing with the philosophy, strategy and objectives of the Company's executive compensation program.

#### *Compensation of the Company's CEO*

The current compensation program for the Company's CEO consists of the following:

*Base Salary* – Base salary is intended to provide the CEO with basic non-variable compensation that is competitive considering the CEO's responsibilities, experience and performance and the Company's financial resources.



In making the base salary decision, the Compensation Committee exercised its discretion and judgment primarily based upon individual performance and competitive considerations. In September 2018, the Compensation Committee recommended, and the board of directors approved, a salary increase for Mr. Harding from \$400,000 to \$425,000 for fiscal 2019. In recognition of Mr. Harding's continuing contributions in 2019 in positioning the Company to realize its long-term objectives, the Compensation Committee recommended, and the board approved, raising Mr. Harding's base salary to \$450,000 for fiscal 2020. At the same time, Mr. Harding was awarded the incentive bonus discussed below in recognition of the significant accomplishments of Mr. Harding and the Company in achieving the objectives set forth in the Company's 2019 performance plan.

*Incentive Bonus* – The Compensation Committee's goal in granting incentive bonuses is to tie a portion of the CEO's compensation to the operating performance of the Company and to the CEO's individual contribution to the Company. In formulating recommendations for bonus compensation for Mr. Harding, the Compensation Committee considered a number of factors, including, among other things, (i) the efforts of Mr. Harding in pursuing projects to achieve long-term goals of the Company; (ii) the progress made by Mr. Harding and the Company in achieving the objectives established by the Compensation Committee for fiscal 2019 (as discussed below); and (iii) Mr. Harding's experience, talents and skills and the importance thereof to the Company.

In September 2018, the Compensation Committee recommended, and the board approved, a performance plan for fiscal 2019, which was comprised of financial and nonfinancial objectives, both short-term and long-term in nature, including objectives related to developing a long-term strategic plan for the Company, development of the Company's Sky Ranch property, improving monthly financial reporting and tracking of project costs, managing the budget, and recruiting additional personnel. The plan also included strategic objectives, the disclosure of which the Company believes would cause competitive harm.

In September 2019, the Compensation Committee reviewed the Company's operating results for fiscal 2019 and evaluated the Company's success in achieving the performance plan objectives. The Compensation Committee determined that a bonus was warranted in recognition of Mr. Harding's continued success regarding the Sky Ranch development, in particular delivering and closing 255 lots ahead of schedule and completing wet utilities to all 506 lots in the first phase of the Sky Ranch development ahead of schedule. In addition, Mr. Harding successfully managed expenses of the Company consistent with the budget and achieved operating revenues in excess of budgeted revenue. The Compensation Committee recommended awarding, and the board authorized awarding, Mr. Harding a discretionary bonus of \$350,000 in fiscal 2019, as well as a stock option to purchase 50,000 shares of common stock, as described below.

*Long-Term Equity Incentives* – The goal of long-term equity incentive compensation is to align the interests of the CEO with those of the Company's shareholders and to provide the CEO with a long-term incentive to manage the Company from the perspective of an owner with an equity stake in the business. It is the belief of the Compensation Committee that stock options and other equity-based awards directly motivate an executive to maximize long-term shareholder value. The philosophy of the Compensation Committee in administering the Company's 2014 Plan is to tie the number of stock options and shares of stock awarded to each employee to the performance of the Company and to the individual contribution of each employee to the Company. The Compensation Committee recommended awarding, and the board authorized awarding, Mr. Harding a non-statutory stock option to purchase 50,000 shares of the Company's common stock, as well as a discretionary bonus of \$350,000, in recognition of his performance during the fiscal year ended August 31, 2019, and to motivate future performance, determining that it would be preferable to recognize his achievements with a mix of cash and long-term incentives.

#### ***Stock Ownership Requirements for Executive Officers***

While the Company has not established stock ownership guidelines for its executive officer, at August 31, 2019, the Company's CEO owned stock with a market value of approximately of eighteen times his base salary, which the Compensation Committee believes appropriately aligns the interests of the CEO with those of the Company's shareholders.

#### ***Hedging Policy***

Company policy prohibits directors, officers and employees from engaging in short sales of Company securities, buying or selling put or call options of Company securities, buying financial instruments designed to hedge or offset any decrease in the market value of the Company securities, or engaging in frequent trading (for example, daily or weekly) to take advantage of fluctuations in share price.

### Employment and Severance Agreements

The Company does not have any written employment, change of control, severance or other similar agreement with the executive officer.

### Executive Compensation Tables

The Company's CEO, Mr. Harding, is the Principal Executive Officer and the Principal Financial Officer of the Company and its only executive officer. Therefore, all tables contained in this section relate solely to Mr. Harding.

#### Summary Compensation Table

Summary Compensation Table					
Name and Principal Position	Fiscal Year	Salary (\$)	Bonus (\$)	Option Awards <sup>(1)</sup> (\$)	Total (\$)
Mark W. Harding . . . . .	2019	425,000	350,000	198,170 <sup>(2)</sup>	973,170
President, CEO and CFO . . . . .	2018	400,000	300,000	285,755 <sup>(3)</sup>	985,755

- (1) The amounts in this column represent the aggregate grant date fair value of stock options awarded in fiscal 2020 and 2019 (for performance in fiscal 2019 and 2018, respectively) as computed in accordance with FASB ASC Topic 718. See *Note 8 – Shareholders' Equity* to the Company's audited consolidated financial statements for the year ended August 31, 2019, which are included in our 2019 Annual Report on Form 10-K for a description of the assumptions used to value option awards and the manner in which the Company recognizes the related expense pursuant to FASB ASC Topic 718.
- (2) The option award was granted and approved on September 27, 2019, with an exercise price equal to \$10.35, the closing market price of the Company's common stock on the date of grant. The option award vests in three equal installments on each of the first, second and third anniversary dates of the grant and will expire ten years from date of grant.
- (3) The option award was granted and approved on September 26, 2018, with an exercise price equal to \$11.15, the closing market price of the Company's common stock on the date of grant. The option award vests in three equal installments on each of the first, second and third anniversary dates of the grant and will expire ten years from date of grant.

**Outstanding Equity Awards at Fiscal Year-End** – The following table summarizes certain information regarding outstanding option awards held by the named executive officer at August 31, 2019. There are no other types of equity awards outstanding.

Outstanding Equity Awards at Fiscal Year-End				
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price	Option Expiration Date
Mark W. Harding . . . . .	100,000	0	\$ 5.88	8/14/2023
Mark W. Harding . . . . .	33,334	16,666 <sup>(1)</sup>	\$ 5.61	10/12/2026
Mark W. Harding . . . . .	16,666	33,334 <sup>(2)</sup>	\$ 7.60	9/27/2027
Mark W. Harding . . . . .	0	50,000 <sup>(3)</sup>	\$11.15	9/26/2028

- (1) One third of the total number of shares subject to the option vest on each of the first, second and third anniversary date of the grant date, October 12, 2016.
- (2) One third of the total number of shares subject to the option vest on each of the first, second and third anniversary date of the grant date, September 27, 2017.
- (3) One third of the total number of shares subject to the option vest on each of the first, second and third anniversary date of the grant date, September 26, 2018.

## REPORT OF THE AUDIT COMMITTEE<sup>1</sup>

The Audit Committee of the board of directors is comprised of independent directors and operates under a written charter adopted by the board of directors. The Audit Committee Charter is reassessed and updated as needed in accordance with applicable rules of the SEC and The NASDAQ Stock Market.

The Audit Committee serves in an oversight capacity. Management is responsible for the Company's internal controls over financial reporting. The independent auditors are responsible for performing an independent audit of the Company's financial statements in accordance with the standards of the Public Company Accounting Oversight Board ("PCAOB") and issuing a report thereon. The Audit Committee's primary responsibility is to monitor and oversee these processes and to select and retain the Company's independent auditors. In fulfilling its oversight responsibilities, the Audit Committee reviewed with management the Company's audited financial statements and discussed not only the acceptability but also the quality of the accounting principles, the reasonableness of the significant judgments and estimates, critical accounting policies and the clarity of disclosures in the audited financial statements prior to issuance.

The Audit Committee reviewed and discussed the audited financial statements as of and for the year ended August 31, 2019, with the Company's independent auditors, Plante & Moran PLLC ("Plante Moran"), and discussed not only the acceptability but also the quality of the accounting principles, the reasonableness of the significant judgments and estimates, critical accounting policies and the clarity of disclosures in the audited financial statements prior to issuance. The Audit Committee discussed with Plante Moran the matters required to be discussed by the applicable requirements of the PCAOB and the SEC. The Audit Committee has received the written disclosures and the letter from Plante Moran required by the applicable requirements of the PCAOB regarding independent auditor communications with the Audit Committee concerning independence and has discussed Plante Moran's independence with Plante Moran.

Based on the foregoing, the Audit Committee recommended to the board of directors that the Company's audited financial statements be included in the Company's Form 10-K for the fiscal year ended August 31, 2019.

/s/ Peter C. Howell (Chairman)

/s/ Harrison H. Augur

/s/ Richard L. Guido

## CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

### Agreements with Related Parties

It is the Company's policy as set forth in its Code of Business Conduct and Ethics that actual or apparent conflicts of interest are to be avoided if possible and must be disclosed to the board of directors. Pursuant to the Code of Business Conduct and Ethics and the Audit Committee Charter, any transaction involving a related party must be reviewed and approved or disapproved by the Audit Committee. Additionally, the Audit Committee Charter requires the Audit Committee to review any transaction involving the Company and a related party at least once a year or upon any significant change in the transaction or relationship. The Code also provides non-exclusive examples of conduct which would involve a potential conflict of interest and requires any material transaction involving a potential conflict of interest to be approved in advance by the board. If a waiver from the Code is granted to an executive officer or director, the nature of the waiver will be disclosed on the Company's website, in a press release, or on a current report on Form 8-K.

The Company annually requires each of its directors and executive officers to complete a directors' and officers' questionnaire that solicits information about related party transactions. The Company's board of directors and outside legal counsel review all transactions and relationships disclosed in the directors' and officers' questionnaire, and the board makes a formal determination regarding each director's independence. If a director is determined to be no longer independent, such director, if he or she serves on any of the Audit Committee, the Nominating Committee, or the Compensation Committee, will be removed from such committee prior to (or otherwise will not participate in) any future meeting of the committee. If the transaction presents a conflict of interest, the board of directors will determine the appropriate response.

<sup>1</sup> This report is not "soliciting material," is not deemed "filed" with the SEC and is not to be incorporated by reference in any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934 (the "Exchange Act"), irrespective of any general incorporation language in any such filing, except to the extent the Company specifically references this report.

## ELECTION OF DIRECTORS (Proposal No. 1)

The Company's board of directors currently has six members. The board of directors nominates the following persons currently serving on the board for reelection to the board: Mark W. Harding, Harrison H. Augur, Patrick J. Beirne, Arthur G. Epker III, Richard L. Guido, and Peter C. Howell.

Set forth below are the names of all nominees for director, all positions and offices with the Company held by each such person, the period during which each has served as such, and the principal occupations and employment of and public company directorships held by such persons during at least the last five years, as well as additional information regarding the skills, knowledge and experience with respect to each nominee which has led the board of directors to conclude that each such nominee should be elected or re-elected as a director of the Company.

**Mark W. Harding.** Mr. Harding joined the Company in April 1990 as Corporate Secretary and Chief Financial Officer. He was appointed President of the Company in April 2001, CEO in April 2005, and a member of the board of directors in February 2004. Mr. Harding brings a background in investment banking and public finance, having worked from 1988 to 1990 for Price Waterhouse's management consulting services where he assisted clients in public finance and other investment banking related services. Mr. Harding is the President and a board member of the Rangeview Metropolitan District, Sky Ranch Metropolitan District Nos. 1, 3, 4 and 5, and the Sky Ranch Community Authority Board and Vice President of the South Metro WISE Authority. Mr. Harding also serves on the board of directors of Hawaiian Macadamia Nut Orchards, L.P., which until June 2018 was a publicly traded limited partnership. In determining Mr. Harding's qualifications to be on the board of directors, the board of directors considered, among other things, Mr. Harding's extensive experience with the Company and his service on a number of advisory boards relating to water and wastewater issues in the Denver region, including a statewide roundtable created by the Colorado legislature charged with identifying ways in which Colorado can address the water shortages facing Front Range cities including Denver and Colorado Springs. Mr. Harding earned a B.S. Degree in Computer Science and a Master of Business Administration in Finance from the University of Denver.

**Harrison H. Augur.** Mr. Augur joined the board and was elected Chairman in April 2001. For more than 20 years, Mr. Augur has been involved with investment management and venture capital investment groups. Mr. Augur has been a managing member of Patience Partners, LLC since 1999. Mr. Augur received a Bachelor of Arts degree from Yale University, an LLB degree from Columbia University School of Law, and an LL.M. degree from New York University School of Law. In determining Mr. Augur's qualifications to serve on the board of directors, the board of directors has considered, among other things, his extensive experience and expertise in finance and law.

**Patrick J. Beirne.** Mr. Beirne was appointed to the board in January 2016. Since April 2015, Mr. Beirne has been the Chairman and CEO of Nelson Infrastructure Services LLC, a private company 50% owned by Mr. Beirne ("Nelson Infrastructure"), and Nelson Pipeline Constructors LLC ("Nelson Pipeline"), a wholly-owned subsidiary of Nelson Infrastructure. In addition, he served as Chairman and CEO of Nelson Civil Construction Services LLC, a 90% subsidiary of Nelson Infrastructure, from its founding in December 2015 until the end of 2018, when Nelson Infrastructure Services was merged into Nelson Pipeline Constructors LLC. Mr. Beirne is the Chairman and CEO of Nelson Pipeline Constructors LLC. Nelson Pipeline is a utility contractor specializing in the construction of underground sewer, water and storm sewer pipelines. Prior to working at Nelson Pipeline, Mr. Beirne worked at Pulte Group, Inc. for 29 years in various management roles, where he gained extensive experience in the home building industry. In his last position with Pulte Group, Inc., from January 2008 to September 2014, he served as Central Area President where he helped create the strategy for the firm's long-term vision and oversaw operations in 10 states. Mr. Beirne earned a B.S. degree from Michigan State University, is a Licensed General Contractor (Florida), and is active in many community and charitable organizations. In determining Mr. Beirne's qualifications to serve on the board of directors, the board has considered, among other things, his extensive experience and expertise in the home building industry and in construction of water and sewer pipelines.

**Arthur G. Epker III.** Mr. Epker was appointed to the board in August 2007. Mr. Epker served as a Vice President of PAR Capital Management, Inc., the investment advisor to PAR Investment Partners, L.P., from 1992 through 2018 and as a director of PAR Capital Management, Inc., from 2007 through 2018. In that capacity, Mr. Epker managed a portion of the assets of PAR Investment Partners, L.P., a private investment fund and shareholder of the Company. Mr. Epker received his undergraduate degree in computer science and economics with highest distinction from the University of Michigan and received a Master of Business Administration from Harvard Business School. In determining Mr. Epker's qualifications to serve on the board of directors, the board of directors has considered, among other things, his extensive experience and expertise in finance and investment management.

**Richard L. Guido.** Mr. Guido served as a member of the Company's board from July 1996 through August 31, 2003, and rejoined the board in 2004. Mr. Guido was Associate General Counsel of DeltaCom, Inc., a telecommunications company, from March 2006 to March 2007. From 1980 through 2004, Mr. Guido was an employee of Inco Limited, a Canadian mining company listed on the NYSE (now known as Vale). While at Inco Mr. Guido served as Associate General Counsel of Inco Limited and served as President, Chief Legal Officer and Secretary of Inco United States, Inc., now known as Vale Americas, Inc. Mr. Guido received a Bachelor of Science degree from the United States Air Force Academy, a Master of Arts degree from Georgetown University, and a Juris Doctor degree from the Catholic University of America. In determining Mr. Guido's qualifications to serve on the board of directors, the board of directors has considered, among other things, his extensive experience and expertise in finance, law and natural resource development.

**Peter C. Howell.** Mr. Howell was appointed to fill a vacancy on the board in February 2005. From 1997 to 2017, Mr. Howell served as an officer, director or advisor to various business enterprises in the area of acquisitions, marketing and financial reporting. From August 1994 to August 1997, Mr. Howell served as the Chairman and Chief Executive Officer of Signature Brands USA, Inc. (formerly known as Health-O-Meter), and from 1989 to 1994 Mr. Howell served as Chief Executive Officer and a director of Mr. Coffee, Inc. Mr. Howell is a member of the board of directors of Great Lakes Cheese, Inc., a privately held company. Mr. Howell served as a member of the board of directors of Libbey Inc. (NYSE:LBY) for over 20 years before resigning in 2016. Mr. Howell also spent 10 years as an auditor for Arthur Young & Co. (now Ernst & Young). Mr. Howell received a Master of Arts degree in Economics from Cambridge University. In determining Mr. Howell's qualifications to serve on the board of directors, the board of directors has considered, among other things, his extensive experience and expertise in finance and financial reporting qualifying him as an audit committee financial expert as well as his general business expertise.

The proxy cannot be voted for more than the six nominees named. Directors are elected for one-year terms or until the next annual meeting of the shareholders and until their successors are elected and qualified. All of the nominees have expressed their willingness to serve, but if because of circumstances not contemplated, one or more nominees is not available for election, the proxy holders named in the enclosed proxy card intend to vote for such other person or persons as the Nominating Committee may nominate.

**THE BOARD OF DIRECTORS RECOMMENDS THAT THE SHAREHOLDERS VOTE "FOR" THE ELECTION AS DIRECTORS OF THE PERSONS NOMINATED.**



**RATIFICATION OF APPOINTMENT OF INDEPENDENT  
REGISTERED PUBLIC ACCOUNTING FIRM  
(Proposal No. 2)**

Action is to be taken by the shareholders at the Meeting with respect to the ratification and approval of the selection by the Audit Committee of the Company's board of directors of Plante & Moran PLLC ("Plante Moran") to be the independent registered public accounting firm of the Company for the fiscal year ending August 31, 2020. In the event of a negative vote on such ratification, the Audit Committee of the board of directors will reconsider its selection. A representative of Plante Moran is expected to be present at the Meeting. The Plante Moran representative will have the opportunity to make a statement if he or she desires to do so and is expected to be available to respond to appropriate questions.

The Audit Committee reviews and approves in advance the audit scope, the types of non-audit services, if any, and the estimated fees for each category for the coming year. For each category of proposed service, Plante Moran is required to confirm that the provision of such services does not impair the auditors' independence. Before selecting Plante Moran, the Audit Committee carefully considered that firm's qualifications as an independent registered public accounting firm for the Company. This included a review of its reputation for integrity and competence in the fields of accounting and auditing. The Audit Committee has expressed its satisfaction with Plante Moran in all of these respects. The Audit Committee's review included inquiry concerning any litigation involving Plante Moran and any proceedings by the SEC against the firm.

Plante Moran has no direct or indirect financial interest in the Company and does not have any connection with the Company in the capacity of promoter, underwriter, voting trustee, director, officer or employee. Neither the Company, nor any officer, director nor associate of the Company has any interest in Plante Moran.

***Change in Auditors for Fiscal 2018*** – As discussed in our Current Report on Form 8-K filed with the SEC on October 4, 2018, EKS&H LLLP ("EKS&H") resigned as our independent registered public accounting firm on October 1, 2018 because EKS&H combined with Plante Moran. On October 1, 2018, the Audit Committee of our board of directors engaged Plante Moran to serve as the independent registered public accounting firm for the Company effective as of that date. EKS&H had been the Company's independent registered public accounting firm since December 4, 2017.

During the period from December 4, 2017 to August 31, 2018, and the subsequent interim period through October 1, 2018, we did not have any disagreements with EKS&H on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to EKS&H's satisfaction, would have caused EKS&H to make reference thereto in its reports on our financial statements for the relevant periods. During the period from December 4, 2017 to August 31, 2018, and the subsequent interim period through October 1, 2018, there were no reportable events, as defined in Item 304(a)(1)(v) of Regulation S-K.

During the fiscal years ended August 31, 2017 and 2018, and the subsequent interim period through October 1, 2018, the Company did not consult with Plante Moran regarding (i) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company's financial statements by Plante Moran, in either case where written or oral advice provided by Plante Moran would be an important factor considered by the Company in reaching a decision as to any accounting, auditing or financial reporting issue; or (ii) any other matter that was the subject of a disagreement between the Company and its former auditor or was a reportable event (as described in Item 304(a)(1)(iv) or Item 304(a)(1)(v) of Regulation S-K, respectively).

***Change in Auditors for Fiscal 2018*** – On December 4, 2017, the Audit Committee engaged EKS&H to serve as the independent registered public accounting firm of the Company beginning with the fiscal year ending August 31, 2018. EKS&H replaced Crowe Horwath LLP (now known as Crowe LLP) ("Crowe") as the Company's independent registered public accounting firm. Crowe, which served as the independent auditors for the fiscal year ended August 31, 2017, was dismissed on December 4, 2017.

The report of Crowe on the Company's financial statements for the fiscal year ended August 31, 2017, did not contain an adverse opinion or disclaimer of opinion and such report was not qualified or modified as to uncertainty, audit scope, or accounting principles.

During the fiscal year ended August 31, 2017, and the subsequent interim period through December 4, 2017 (the date of the change in auditors), the Company did not have any disagreements with Crowe on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to Crowe’s satisfaction, would have caused it to make reference thereto in its reports on the Company’s financial statements for the relevant periods. During the fiscal year ended August 2017, and the subsequent interim period through December 4, 2017, there were no reportable events, as defined in Item 304(a)(1)(v) of Regulation S-K.

During the fiscal years ended August 31, 2017 and 2016, and the subsequent interim period through December 4, 2017, the Company did not consult with EKS&H regarding (a) the application of accounting principles to a specified transaction, (b) the type of audit opinion that might be rendered on the Company’s financial statements by EKS&H, in either case where written or oral advice provided by EKS&H would be an important factor considered by the Company in reaching a decision as to any accounting, auditing or financial reporting issues or (c) any other matter that was the subject of a disagreement between the Company and its former auditors or was a reportable event (as described in Item 304(a)(1)(iv) or Item 304(a)(1)(v) of Regulation S-K, respectively).

**Fees** –The following table sets forth the aggregate fees the Company was billed by Plante Moran and EKS&H for the fiscal years ended August 31, 2018 and 2019. 100% of the services in the table below were pre-approved by the Audit Committee in accordance with the Audit Committee Charter.

	<u>For the Fiscal Years Ended</u>	
	<u>August 31,</u> <u>2019</u>	<u>August 31,</u> <u>2018</u>
Audit Fees <sup>(1)</sup> .....	\$110,000	\$105,000
Audit-Related Fees .....	\$ —	\$ —
Tax Fees <sup>(2)</sup> .....	\$ 6,500	\$ —
All Other Fees .....	\$ —	\$ —
<b>Total</b> .....	<b><u>\$116,500</u></b>	<b><u>\$105,000</u></b>

(1) Includes fees for the audit of the Company’s annual financial statements, the reviews of the Company’s quarterly financial statements and consents and other services normally provided by the independent auditors in connection with statutory and regulatory filings or engagements for those fiscal years, regardless of when the fees were billed or services were rendered.

(2) The tax fees consist entirely of fees for the preparation of the federal and state corporate tax returns.

**Pre-Approval Policy** – The Audit Committee has established a pre-approval policy in its charter. In accordance with the policy, the Audit Committee pre-approves all audit, non-audit and internal control related services provided by the independent auditors prior to the engagement of the independent auditors with respect to such services.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE “FOR” THE RATIFICATION OF THE APPOINTMENT OF THE INDEPENDENT AUDITORS.**

**ADVISORY VOTE ON EXECUTIVE COMPENSATION  
(Proposal No. 3)**

The following proposal provides our shareholders with the opportunity to vote to approve or not approve, on an advisory basis, the compensation of our named executive officer as disclosed in the proxy statement in accordance with the compensation disclosure rules of the SEC.

We urge shareholders to read the “*Executive Compensation*” section beginning on page 10 of this proxy statement, as well as the Summary Compensation Table and other related compensation tables and narrative, beginning on page 12 of the proxy statement, which provide detailed information on the compensation of our named executive officer. The Company’s compensation programs are designed to support its business goals and promote short- and long-term profitable growth of the Company.

We are asking shareholders to approve the following advisory resolution at the Meeting:

RESOLVED, that the shareholders of the Company approve, on an advisory basis, the compensation of the Company’s named executive officer, as disclosed pursuant to Item 402 of Regulation S-K, including the disclosure under the heading “Executive Compensation” and in the compensation tables and accompanying narrative discussion in the Company’s Definitive Proxy Statement.

This advisory resolution, commonly referred to as a “say-on-pay” resolution, is not binding on the Company or the board of directors. The say-on-pay proposal is not intended to address any specific item of compensation but rather the overall compensation of our named executive officer and the executive compensation policies, practices, and plans described in this proxy statement. Although this proposal is non-binding, the board of directors will carefully review and consider the voting results when making future decisions regarding the Company’s executive compensation program. Based on the advisory vote of the shareholders at the annual meeting of shareholders held in January 2014, the board of directors determined that it would conduct an advisory vote on executive compensation on an annual basis. Notwithstanding the foregoing, the board of directors may decide to conduct advisory votes on a more or less frequent basis and may vary its practice based on factors such as the results of the vote on Proposal No. 4 (described below), discussions with shareholders and the adoption of material changes to compensation programs.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE “FOR” THE APPROVAL, ON AN ADVISORY BASIS, OF THE COMPENSATION OF THE COMPANY’S NAMED EXECUTIVE OFFICER.**



**FREQUENCY OF ADVISORY VOTE ON EXECUTIVE COMPENSATION  
(Proposal No. 4)**

The Dodd-Frank Act provides that shareholders must be given the opportunity to vote, on a non-binding, advisory basis, at least once every six years for their preference as to how frequently we should seek advisory votes on the compensation of our named executive officer as disclosed in accordance with the compensation disclosure rules of the SEC. By voting with respect to this Proposal 4, shareholders may indicate whether they would prefer that we conduct advisory votes on executive compensation every one, two, or three years. Shareholders also may, if they desire, abstain from casting a vote on this proposal.

After consideration of the various arguments supporting each frequency level, the board of directors recommends that future advisory votes on the compensation of the Company's named executive officer occur every three years. We believe that conducting an advisory vote on executive compensation every three years reflects the appropriate time frame to enable us to evaluate the results of the most recent advisory vote, to develop and implement any adjustments to our compensation programs that may be appropriate in light of the advisory vote, and for shareholders to evaluate the effects of any changes to our compensation program, especially compensation goals related to long-term motivation. In this regard, because the advisory vote on executive compensation occurs after we already have implemented our executive compensation program for the current year, we expect that in many cases it may not be appropriate or feasible to fully address and respond to any one year's advisory vote on executive compensation by the time of the following year's annual meeting of shareholders.

Although we currently believe that holding an advisory vote on executive compensation every three years reflects the right balance of considerations in the normal course, the board of directors will determine the frequency of future votes on executive compensation after taking into consideration the preferences of the shareholders as reflected by the results of the advisory vote at the Meeting. The proxy card provides shareholders with the opportunity to choose among four options (holding the vote every one, two, or three years, or abstaining). The option that receives the most votes cast at the Meeting will be considered the frequency preferred by the shareholders.

The shareholder vote on the frequency of future advisory votes is advisory and not binding on the Company or the board of directors. Notwithstanding the recommendation of the board of directors and the outcome of the shareholder vote, the board of directors may decide to conduct advisory votes on a more or less frequent basis and may vary its practice based on factors such as discussions with shareholders and the adoption of material changes to compensation programs.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE OPTION OF ONCE EVERY THREE YEARS ON PROPOSAL NO. 4 REGARDING THE FREQUENCY OF THE SHAREHOLDER ADVISORY VOTE ON APPROVAL OF COMPENSATION OF THE COMPANY'S NAMED EXECUTIVE OFFICERS.**

## **ACTION TO BE TAKEN UNDER THE PROXY**

The proxy will be voted “FOR” the individuals nominated by the board, “FOR” approval of Proposals 2 and 3, and as an abstention on Proposal 4, unless the proxy is marked in such a manner as to withhold authority to so vote. The proxy will also be voted in connection with the transaction of such other business as may properly come before the Meeting or any adjournments or postponements thereof. Management knows of no other matters, other than the matters set forth above, to be considered at the Meeting. If, however, any other matters properly come before the Meeting or any adjournment thereof, the persons named in the accompanying proxy will vote such proxy in accordance with their best judgment on any such matter. The persons named in the accompanying proxy will also, if in their judgment it is deemed to be advisable, vote to adjourn the Meeting from time to time.

## **OTHER INFORMATION**

### **Delinquent Section 16(a) Reports**

Section 16(a) of the Exchange Act requires our directors and executive officers and persons who own more than 10% of our common stock to file with the SEC initial reports of ownership and reports of changes in ownership of common stock and other equity securities of the Company. Based solely on our review of copies of the reports filed with the SEC and written representations from such reporting persons, we believe that during the fiscal year ended August 31, 2019, all officers, directors and shareholders owning more than 10% of the Company’s common stock filed the reports required by Section 16(a) on a timely basis, except that Mr. Harding inadvertently filed a Form 4 one day late with respect to a grant of a non-statutory stock option to purchase 50,000 shares of the Company’s common stock that he received on September 26, 2018.

### **Shareholder Proposals**

Shareholder proposals for inclusion in the proxy statement for the annual meeting of shareholders in 2021 must be received at the principal executive offices of the Company by August 7, 2020, but not before June 8, 2020. For more information refer to the Company’s bylaws which were filed as Appendix C to the Proxy Statement on Schedule 14A filed with the SEC on December 14, 2007. The Company is not required to include proposals received outside of these dates in the proxy materials for the annual meeting of shareholders in 2021, and any such proposals shall be considered untimely. The persons named in the proxy will have discretionary authority to vote all proxies with respect to any untimely proposals.

### **Delivery of Materials to Shareholders with Shared Addresses**

The Company utilizes a procedure approved by the SEC called “householding,” which reduces printing and postage costs. Shareholders who have the same address and last name will receive one copy of the Important Notice Regarding the Availability of Proxy Materials or one set of printed proxy materials unless one or more of these shareholders has provided contrary instructions.

If you wish to receive a separate copy of the proxy statement, the Notice, or the Company’s Annual Report on Form 10-K, or if you are receiving multiple copies and would like to receive a single copy, please contact the Company’s transfer agent at 1-877-830-4932, or write to or call the Company’s Secretary at the Company’s address or phone number set forth above. If your shares are owned through a bank, broker or other nominee, you may request householding by contacting the nominee.

### **Form 10-K and Related Exhibits**

The Company’s Annual Report on Form 10-K is available, free of charge, at the Company’s website, [www.purecycwater.com](http://www.purecycwater.com), or at the SEC’s website, [www.sec.gov](http://www.sec.gov). In addition, the Company will furnish a copy of its Form 10-K to any shareholder free of charge and a copy of any exhibit to the Form 10-K upon payment of the Company’s reasonable expenses incurred in furnishing such exhibit(s). You may request a copy of the Form 10-K or any exhibit thereto by writing the Company’s Secretary at Pure Cycle Corporation, 34501 E. Quincy Avenue, Bldg. 34, Box 10, Watkins, CO 80137, or by sending an email to [info@purecycwater.com](mailto:info@purecycwater.com). The Company also makes available on its website copies of the charters of the Audit, Compensation and Nominating and Corporate Governance Committees of the Board, its Code of Business Conduct and Ethics, Audit Committee Whistleblower Policy, Shareholder Communications Policy and Corporate Governance Guidelines. The Company’s website and the information contained on or connected to its website are not incorporated by reference herein and its web address is included as an inactive textual reference only.

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This Annual Report to Shareholders, including the letter to the shareholders from President Mark W. Harding, contains forward-looking statements within the meaning of Section 27A of the Securities Exchange Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934 1934, as amended. The words “will”, “expect”, “should”, “scheduled”, “plan”, “believe”, “promise”, “anticipate”, “could” and similar expressions are intended to identify forward-looking statements. Pure Cycle expectations regarding these matters are only its forecasts. These forecasts may be substantially different from actual results, which are affected by many factors. The use of “Pure Cycle”, “our”, “we”, and similar terms are not intended to describe or imply particular corporate organizations or relationships.

**Executive Officer and Directors**

*Mark W. Harding - President, Chief Executive / Financial Officer, Director*

*Harrison H. Augur - Chairman of the Board*

*Richard L. Guido - Nominating and Governance Committee Chairman*

*Peter C. Howell - Audit Committee Chairman*

*Arthur G. Epker III - Compensation Committee Chairman*

*Patrick J. Beirne - Director*

**Corporate Legal Counsel**

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Denver, CO 80202  
303.892.9400

**Independent Registered Public Accountants**

Plante & Moran PLLC  
8181 East Tufts Avenue, Suite 600  
Denver, CO 80237  
303.740.9400

**Stock Transfer Agent & Register**

Broadridge Corporate Issuer Services, Inc.  
1717 Arch Street, Suite 1300,  
Philadelphia, PA 19103  
855.418.5058



Our stock is traded on the NASDAQ Capital Market under the symbol “PCYO”.  
For more information please visit our website at [www.purecyclewater.com](http://www.purecyclewater.com)