Transcript of
Pure Cycle Corporation
Pure Cycle Corporation Year Ended 2022 Earnings Call
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Participants

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Analysts

William Miller - Private Investor
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Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the Pure Cycle Corporation Year ended 2022 Earnings Call. [Operator Instructions].

It is now my pleasure to turn the floor over to your host, Mark Harding. Sir, the floor is yours.

Mark Harding - President and CEO, Pure Cycle Corporation

Thank you. Good morning, everyone. I'd like to welcome you to our year-end earnings call. Just a few housekeeping items. We do have a deck for this call, if you log in to our website at purecyclewater.com, there'll be a link over to the Investor page, and then there'll be a tab on that page that allows you to join. So click that join button and then I'll be able to advance the slides through the presentation and you'll have the deck on there, and then the deck will also be a PDF of the presentation will be on the website for reference on you want to get into reading it in a little bit more detail.

With me today is both Kevin McNeill, who has been a little under the weather, so he's going to take a listen only mode on that as well as Dirk Lashnits who handles all of our land development activities. And so other than hearing from me, you'll have a chance to hear from Dirk on some of the land activities and our successes in that area as well.

So with that, I'd like to just start with the presentation. And the first thing we need to do is talk about our safe harbor statement, which is that historical fact not contained or incorporated by reference in this presentation are forward-looking statements. I think you all are familiar with the forward-looking statements and the safe harbor statement so we can get the lawyers out of the room.

I'm going to really kind of brief through some of the overview question -- overview of the company. Most of you are going to be familiar with the company. And if you're not, certainly, you can go back and take a look at this portion of the presentation in a little bit more detail. There's a ton of information about the company on our website. So I encourage you to spend some time there and take a look at the resources that we have on the website to give you a little bit more specificity to what it is that we do.

But really, we have 3 operating segments, and they're all very complementary, really at the foundational level, we are Water and Wastewater resource company. We own a large portfolio of water in a valuable part of the country where you can own water. We develop that water cradle-to-grave water service to customers -- we have land that's in the right location in the Denver metropolitan area along the [Idemity corridor] that we're developing a master planned community on.

And then we hold back some of those lots that we develop for our homebuilder customers and we keep them for an opportunity to build homes on them and enter into the single-family rental market, where we continue to have an ongoing cash flow from an appreciating asset that provides terrific margins for us because we're able to carry forward the equity value that we have both in the land and the water utility segment.

So I'll just briefly talk a little bit about each of the segments. As I mentioned, the water, the wastewater segment. We develop the wells, diversions, all the water supply. We treat that water supply. We distribute that to our customers. We get 2 fee instruments for this. We get a connection fee, which is referred to here in Colorado, the tap fee. And our water tap fees are right around $28,000. Our sewer tap fees are right around $5,000.

We have the capacity to provide water and wastewater service to approximately 60,000 connections. And then as we have those connections signed up to the company, we get ongoing water and wastewater revenues each month. So we have monthly water, wastewater service sales to that. That generates about $1,500 per connection per year on that side. We collect that wastewater back. We process that wastewater into usable water supply for our outdoor irrigation or our industrial water supply customers.

And really, we have water, a very tight water balance system where we're taking our water supplies, whether they're ground water supplies, surface water supplies, bringing them into a treatment system sending that into the customer. We have some of that use that's going to be outdoor irrigation, which results in a bit of a loss, but we do have mechanisms for recapturing that in terms of the water right systems. And then we also take and reuse that system and then are able to reuse that into our industrial customers. So really are investing into a sustainable water balance system for the company and for our customers.

We continue to grow our infrastructure asset base. So over the last 5 years, you see almost a doubling of our investments in our water investments and water infrastructure, really across the board with wells, transmission lines, storage, treatment facilities, all of the distribution facilities and then the wastewater treatment facilities that we claim that water supply.

Water growth, so we have existing areas where we're growing our customer base. One of those is new residential connections, whether that's going to be in our Master Planned Community of Sky Ranch, whether that's going to be commercial users, both in Sky Ranch as well as another service area that we have, a little bit south of the Sky Ranch area called the Wild Pointe service area, and then existing industrial customers.

So we continue to grow our customers year-over-year. We're right around 1,000 connections to the systems today. Another important customer that we have is our industrial customers. So we happen to be on a very prolific oil and gas field. It sits right on top of where our water supplies are. We have multiple operators that are developing the field in this area, multiple formations, and so we distribute raw water and reclaim water sources to our oil and gas customers and generate high volume of water supply as well as high volume for selling that water to our customers, and really had a record year this year in selling water to the oil and gas segment, and that's largely a function of the price of oil, the regulatory climate in Colorado kind of settling down, operators being more comfortable with how they're operating within the heightened regulatory climate that Colorado offers them.

One of the things I'd like to highlight is kind of where we are geographically in Denver metropolitan area. As most of you know, we are along the foothill areas, and we might as well be along an ocean because we really can't grow to our west, the mountains, and we have a geologic barrier there that prohibit really any substantive growth in the Denver area. And so really, we're constrained to really a 180-degree semi-circle for growth activity in the Denver metropolitan area.

If you look at the map over on the right side of this, the difference between the orange and the green there, it's really green line there. That's Interstate-70 that's the East-West transportation corridor in the Denver metropolitan area and then we have belt loop. You can see the 470 belt loop. Right at the top of that is going to be the Denver International Airport. So our Sky Ranch project is 4 miles directly south of that. And then our Lowry Range service area, which is that large pink area, and this kind of gives you a feel for where development has grown in the Denver metropolitan area, not only to the Sky Ranch property, which is our Master Planned Community, but also opportunities for the Lowry service area and being able to take a look at new development activities in that Lowry service area. So that's kind of give you a perspective on kind of where we are positioned in the residential area.

I'm going to turn the call over to Dirk. He's going to give you a bit of an update on our land development segment and all of the exciting activities that we have in there, Dirk want to and take it over.

Dirk Lashnits - Vice President, Land Development, Pure Cycle Corporation

Right. Thanks, Mark. Good morning, everyone. Land development is the Sky Ranch project, our Master Planned Community. This information is probably a little old hat, but it's will stay the same for the duration of the project. So we see that the slide of the iteration curve for the next several years to come. So Sky Ranch is 930 acres. We can accommodate up to 3,200 residential lots, about 2 million square feet of commercial development.

Go to the next slide here. All right. So again, a little old had our first phase. This phase of the project kicked off in earnest in 2018. I think it gives a pretty good frame of reference for the overall project and sort of a basis. So this phase encompasses 509 lots. This is wrapping up as we speak. If you look at the top right-hand corner of the graphic on the page, you can see the last little bit of homes under construction right now. So we're finishing this project off. Based on the project off, we've sold all our taps.

All the homes have been started. Last few residents are moving in. We've turned over all the infrastructure to the respective jurisdictions. We've collected all our lot revenue that's the $36.7 million. That's for our lot sales, $14 million for our tap. We also did a bond on these -- on this phase in 2019. That was about $30 million, something like that. And then we have some reimbursable costs accruing out here on these for future.

All right. So then we move over to our second phase. This is the most current phase right across the street to the East. What you're looking at on the graphic, the lots are down in the right-hand corner and then the upper right-hand corner are school. So the biggest thing difference on going into this phase is we really took a new look at our land plan out here. You can kind of see the layout of the Phase 1 versus the Phase 2 changes pretty significantly. We introduced some new product lines, our first phase has basically 2 product types. In this next phase, we went up at 6, and we really -- our first phase, we inherited with the project and in the second phase, we really took a deliberate look at how we wanted to plan this out.

Our motivation was largely a density. Our first phase, we're looking at about 3 houses per acre, and if you carry that through our whole project, we really would fall short of what the whole project -- the capacity for the whole project would not get us up to that 3,500 or 3,200 lots. So trying to incorporate more density into the project going forward, we got that up to about 5 or 6 houses per acre. And that density really helps us from a bonding standpoint and helps us on our water usage standpoint as well.

So we have, like I said, new product lines in this neighborhood. We added a fourth builder. So trying to find the right balance of number of builders, whether it going to be either 3 like our first phase or whether it going to 6, so we ended up with 4 builders in this phase. We felt like that was a pretty good sweet spot. And in our analysis, that was where we felt the best yield was. So 4 builders in this phase, it's important. They got the purple lots, challenger homes. They are in the light green. Lennar is the blue lots in KV is the time lots. And each one of those builders have a unique -- at least one unique product segment, and then there's a little bit overlap to get to this mix. So they're competing on one product site.

I think in the future, we'll carry this same concept through at least through the build-out of our second phase. So what you're seeing here on the first stage is the first quadrant of this is 1 of 4. So this concept repeats itself 3 more times in the first -- in the second phase. And then we have our future phases, and we'll analyze whether that's a good concept and whether we carry this through, and then there are some opportunities for some other product segments as we go forward in the overall community. Those would be like a multifamily attached product and then possibly some active adults.

So we've got a lot of revenue in here, $70 million. I think that's up from our first phase on per lot basis by about 15% through in reimbursables in here and then we did another bond in 2022 on this Phase 2. This is the 850 lots. And that was a $29 million bond on that. And that, again, was up from our first phase. We saw some good appreciation going from Phase 1 to Phase 2.

So the next slide just kind of shows a breakout of the 4 different quads that I mentioned, so if you look at that center pie chart there, those are the -- those different colors represent the 6 different product types that we're building. The next pie chart over to the right, that's our builder segmentation. So I think we got a good parity craft there, good distribution of product types and a good distribution of builder lots. And you can see the numbers of each phase. So 2A I was on the previous slide, that represents that first supply that we're building there. And so these will roll out roughly year-over-year, so 2A underway right now. And actually, that's nearing completion. We have received all our lot revenue less a few little outstanding items here and there. And then we'll move into our next phases as we move through that.

Mentioned the school. So this is a view looking towards the west. So more towards the left hand of the screen, you see the street stage of completion for the Phase 2A. There's 1 little model house in there. That's a challenger house there. This was a few months old. We got a significantly more amount of vertical construction going on in there. But -- the -- on the right-hand side of the screen, you see the graphic layered in there for the academy, the charter school for Sky Ranch.

And we are sort of the center of the screen, there's the gray H-shaped object. That's going to be the elementary school that is -- that has started construction. They built that foundation, and they're going to go vertical on that here in just the next couple of weeks. So that's pretty exciting. That will open next fall as a K7 and then they start to add years and a year later, we go over to the high school phase, which is the E-shaped gray structure that will come online subsequent years.

All right, real quick talk about some market conditions that we're seeing, a very pretty set this right now. Slide is a little bumpy here, so we're in a contracting market. Some experts are called it a housing recession. So some quick indicators. You see these all over the Internet.

I pulled out a couple of key metrics here. Our new home sales across the country are down 17% year-over-year. New home -- I'm sorry, mortgage applications are down 40% year-over-year. And our -- build our confidence levels are down for 10 months in a row. So watching those sort of sentiments.

We talk about interest rates. We had a pretty abrupt uptake in 2022. It went from basically 3% to 7%. And looking at those interest rates kind of across historically, we're not -- not crazy out of line. If you go back through the decades, from the '70s, we had about an average interest rate of 7.76% since 1970. So in the 80s, so let us remember, we hit that 18% mark in -- but they've been right around that 7% for the last half century or so.

And then our material and labor costs, we're seeing -- so typically, we would see probably a couple of percentage point increase year-over-year. That's something that we build into our contracts and anticipate. So that's pretty typical, but just the last year, our material labor costs have been up 20% over last year and up 40% since the start of the pandemic. So those are affecting our builder partners and how they can sell a house. And kind of the net of that is our -- our product costs are up and our customers' buying powers are down. So that's kind of on the bad side.

On the good side, we still are seeing a strong demand for new home sales just as a comparison. We peaked in the 2005, 2006 time period, we were -- we were producing about 1.4 million units a year new houses per year. And in 2021, this last little run-up, we were only hitting about 600,000. So there would appear to still be some pretty good capacity in the market there.

A couple of other positive indicators are average days on the market for a home. Typically, we see like a 60/90 days on the market. So that's seasonal. So days in the high-selling season, which is summer and then 90 days is lot longer in the winter. And just to note, we are in a on the downward trend on that right now going into the winter.

So our current sales cycle is on the way down and then it starts ticking back up late winter, early spring. So that's typical, but we're currently seeing like a 30/60 base on the market. So that's going in the positive direction.

We are still seeing positive home appreciation, it's less than what it was, but I think a lot of us were seeing inclined to think that, that appreciation was probably pretty unsustainable. So that coming down a little bit pretty positive thing.

Short-term mortgage options. We're starting to see some creativity on the lending side to help compensate for the other increased costs. So do these Q1 buydowns now. So figuring out other creative ways to help our buying customer, and then still seeing the low unemployment, especially here in Colorado.

So our takeaway is that we're -- a correction is necessary and hoping it's not going to be a collapse. So market is kind of recalibrating on all fronts for that correction and out of Sky Ranch. What we're looking at doing is reevaluating the timing on the next set of lots that we deliver to our builders. So as those builders see a slowdown in their sales and when they'll need to take the lots on from that next phase, that be our Phase 2B.

Next slide, just a little bit more graphic representations of some of the market stats. First ones are housing supply, lending standards, hopefully significantly different from like the 2008 recession, some of those lease lending standards there and then not seeing any foreclosures really at this point. So set a good sign and that unemployment back is function of that. I think that's a related and I'll turn it back over to Mark.

Mark Harding - President and CEO, Pure Cycle Corporation

Great. Appreciate that. Thanks Dirk. So I want to talk a little about our last business segment, single-family rentals. More recently, we've added this new business really through retaining lots in our Master Planned Community. And so we want to develop these lots into single-family rentals mostly for the appreciation that we're getting and seeing in the Master Planned Community, we're actually causing that appreciation as we do what we do well on the development side, creating a nice place of home on that. We see a significant increase in value for those. And then it's a great opportunity for us to continue to invest in the company and provides ongoing cash flow. So we really like that complement to our water and land development activities. And so we're going to continue to see some more activity there.

Some of the specifics on this are the trends in the consumer preferences, home versus apartments. We have a significant recalibration of consumers seeking more space rather than location. Affordability is a key driver in this area. And as Dirk mentioned, we've really concentrated on a broader product class. We've got more -- we've got paired homes. We've got townhomes, so they're all going to be delivering at an entry-level price point that's going to be more flexible for the consumer as well as for the renter.

And so we have a number of different product offerings so that when somebody comes to us, with an interest to rent on a single-family home level, we have everything from a large 4-bedroom home with a dent to maybe a 2-bedroom home that would be in a townhome type product. So those price points will be flexible for all sorts of customers in there and really a continuing strengthening of the market for home rentals. So we like that on both a local and national trend for the single-family rental market.

This is just some of the statistics on our single-family rentals and how those cash flows come to us. And so if you take a look at it on an average home, we're generating about $33,000 in annual revenue income. This is a little bit of our operating costs, which are going to be our taxes and our dues and then interest cost, depreciation expense, and then when you're adding back those cash flows, we end up getting very high margins in this thing. So we are able to carry forward the equity value of the land and water in the rental segment to provide those free cash flows to us.

So we really like this segment. We're going to continue to invest in that. We have currently 4 rentals up and available. We had 3 last year. We just added on this week, actually, and we have another 10 under construction. So to give you a bit of metrics on what we're looking for on carrying forward that into this next phase. Again, the diversity of the product mix. This is Phase 2A. So if you look at what we're getting in terms of our products on the what we've sold to our builder customers, we're also retaining some of those for our own purposes. So we have few flex homes. We have small 35-foot alley load product and then we also have more of the same product that we had in the first phase. And our rents are going to range anywhere from slightly less than $2,400 a month to $3,000 a month. So great opportunities for us on the single-family rental market.

I want to drill down on some of the specific financial highlights. We've had a fantastic year. As you saw from some of our press releases, continued execution, continued growth in the Water and the Wastewater segment. We continue to invest in that. So we have around $67 million in water asset capitalized cost. Again, this -- we continue to grow that segment. We had a little opportunistic acquisitions in that area. So we purchased a little more water that was regionally in an area that was located for some other water rights that we had.

Water has never been more relevant. I know that many of you, I'm sure, have seen all of the press about Western Water and the supplies on the Colorado River. Most of our supplies are not on the Colorado River. They're more on the Flat River. We've had a relatively normal water year, but water continues to be one of those high-value investments in those highly sought-after opportunities. So we continue to look at that.

And then water deliveries, we had a record year in water deliveries, over 400 million gallons of water deliveries, generating record revenue for us in that segment.

So continuing with our land development activities. As Dirk was highlighting, we've delivered 100% of the Phase 1, both in terms of the water and the land development revenues on Phase 2A, we're about 76% complete on that, maybe a wee bit more than that and really have delivered all of those lots to our homebuilder customers.

And as we also highlighted, we had another bond reimbursables to recover some of those public improvements that we continue to invest in, not only carrying forward some of those from Phase 1, but also some of those in Phase 2. And then we continue to generate very nice gross margins on our lot sales. When you take a look at both the lot sales as well as the reimbursables that come back to us on that.

So very high opportunity on the land development side that has generated record liquidity for us. We've had some outstanding execution and really very low exposure. Our business model here is allowing us to be able to develop this infrastructure and deliver that in real time. So neither we nor our homebuilder customers are exposed to anything other than what we've delivered. And the opportunity for us is really to continue to partner with them on market demand forces on that.

And then the single-family rentals, again, continued growth in the home rental market. So we like very much delivering more homes in that area. Take some highlighting some financial metrics. Again, revenue. We have about $23 million in revenue, $8 million of that came from Water and Wastewater and then $15 million of that came from primarily our Land Development segment. Great growth in our net income, as you can see, from very modest means as we started this endeavor in 2018.

The big highlight in 2021 was kind of an accounting recognition issue of being able to be comfortable with recurring or recapturing those public improvement investments. So those are more real-time recognized revenues as opposed to accrue those and then recognize some of those in previous years into that 2021 area. And then our margins continue to improve. So we're very proud of our team and the ability to continue to execute on both the water utility, the land development segment, and we look forward to continuing to highlight as it becomes more material to single-family rental segment.

Again, more asset growth. We continue to invest in our assets, water, wastewater, water rights and then ultimately showing you record liquidity right around that $35 million of cash and cash equivalents for year-end. So an outstanding year for us, and we're really proud of kind of how this is timed out for us. So we're in a very good position as we're taking a look at being opportunistic on some of the investment side.

Do you want to talk a little bit about our ESG initiatives. So we've hired an ESG initiative specialist who continues to really develop our documentation for ESG activities. We want to be -- we want you to be on the lookout for that. So we'll have our first annual ESG report coming up later this month. We'll post that to our website. So be on the look for that.

We want to be on the forefront on some of this disclosure and this documentation, both from an SEC guidance standpoint as well as what the NASDAQ Exchange are going to be looking for. So you will see significant documentation and really how the company perceives that. It's a high initiative for us.

Things to look for specifically are assessing, tracking and disclosing energy management uses, network efficiency, water usage, water recycling, wastewater collection data, those sorts of things. We can track -- we are going to track and assess employee satisfaction water affordability and access, staff diversity, all those sorts of highlighting issues and then continue the board diversity matrix as required by NASDAQ. So you'll continue to see more on that.

A little bit on some of the highlights here. Balance sheet, terrific balance sheet, $35 million in cash, very low debt position, low debt position at some favorable interest rates. So we locked in a lot of that financing at the 4.5% interest rate. So those have worked well for us.

Total revenues, if you take a look at the income statement, again, $23 million for 2022. And then almost $10 million in net income, $0.40 per share on a diluted basis.

I also want to talk a little bit about some other tools. So we are adding a new tool to our box through a Board authorization for a share repurchase program. And really looking at this as being kind of the anti-dilutive nature of it, we are very -- as many of you know, we're very hawkish on our denominator and our capital currency. We have not raised capital through the sale of stock since we acquired Sky Ranch back in 2010.

And we're very modest on our stock option plans. We do want to incentivize our employees to be owners of the company. And so this is an important component of that. But we're also being opportunistic to invest in ourselves. And so this is an authorization that the Board took as an opportunity for us to take a look at some of our liquidity and take a look at some of the market valuations and the disconnects that maybe we believe that the market may perceive compared to what our intrinsic value is. So you'll see a little bit of that. And you'll see that disclosure as we take advantage of that through the next several quarters.

A couple of upcoming important dates, proxy statements and proxy cards will be mailed out on December 2. We'll have an annual shareholder meeting in January. So this year's meeting will be on January 11. And then again, the ESG report initiatives will be later this month.

Take a look at kind of our leadership. We continue to have very solid leadership both at the staff level as well as the Board level. We have we're highly complemented by just an outstanding intellectual capital within our Board of Directors. And so they provide great governance and great direction for us on an ongoing basis. So I couldn't be more thrilled to have their continued leadership in scope.

Okay. Before I finish with my closing remarks, let me just give you a bit of a recap here. We had a terrific year delivering lots that really were on schedule and in budget. We were able to generate significant liquidity through the sale of the CAB bonds. And really, that was a direct result of our excellent credit quality, how we develop, how we do land development, the opportunity for us to invest and then be reimbursed. Those -- that business model really paid dividends for us, not only delivering these next set a lot in a real-time fashion, but also being able to recapture some of that liquidity through a bond offering.

And really, how do we know our business model is working because when you see markets shift like this, neither we nor our builders are overly exposed. Our builders have tightened their budgets for 2023, but we're one of the few developers that actually are providing finished lots in this market and providing them at the entry level where everybody wants to be. Prior to -- and I'll give you kind of a dynamic here prior to in 2007 -- prior to the recession of 2007, the Denver market here, home starts and entry-level home starts represented about 50% of the overall market. So you really had a concentration of builders and developers really pursuing that first-time buyer market. And that number has fallen to closer to 5%.

So we have an affordability problem in Colorado, and that's primarily because of a number of reasons. And really, Sky Ranch is one of the few projects out there that's delivering lots for homebuilders in that starter home market. The demand for housing in Denver remains strong. So we're well positioned at that entry-level market. We're selling homes, our homebuilders are selling homes to new buyers versus a trade-up buyer. New buyers that we'll have to get comfortable with what is going to be this recalibrated mortgage. The anomaly isn't 7%, the anomaly was 4%, 3% mortgage, I think that 7% number, as Dirk highlighted, is really more of a traditional average on that. And then we're not really selling to buyers with an existing rig, right? They're not a trade-up buyer. These are new buyers in the market.

We have a lot of optionality in this company and terrific balance sheet, great liquidity to make disciplined acquisitions, both in land and water and now with our new tool in the box, we can invest in ourselves. So we're very delighted to have the liquidity that we have right now, and we'll continue to look at opportunities to continue to grow the company.

So with that, I think I'll turn it back over to Ali and see if you all have some questions that we can drill down to and answer some specifics.

Operator

[Operator Instructions] Our first question is coming from Bill Miller, who is an investor.

Q: I congratulate you on a great quarter, and I'm just curious about a couple of things. One is your acquisitions that you alluded to, and where are you on any big further land acquisitions along I-70 or anywhere else?

And secondly, the home rental market is obviously a home loan for you. Are you going to expand beyond the 100 a year or whatever number you have because that's certainly your highest return investment opportunity you have. So will you reallocate resources there?

And finally, are you going to stop at 200,000? Or are you going to go beyond that? and how aggressively do you plan to pursue that at this price?

Mark Harding - President and CEO, Pure Cycle Corporation

Yes. So let me take them in the order presented if I can remember that. So on the land acquisitions, we certainly do have a high degree of interest for that. And as we've talked in the past, I think we're very well known in the market segment. We have water, which most of these surrounding land, the interest do not have water. So the intrinsic value of us being able to acquire a piece of land at our water to it does add value in the equation.

And while we have not broken any of those free yet, we are seeing a lot of movement in this area, so we're very interested to continue to pursue that. We're very active in pursuing that, and we have a high degree of liquidity to pursue that with. So we very much like that optionality and being able to do that.

As you see, we continue to try and do some tuck-in acquisitions on the water side. I'd say our preference would be more land and water. But when water is available that we have that's going to be located near where our existing supplies are that make sense for us to add. We'll continue to do that.

In taking a look at the single-family rental market, that's also a great opportunity for us. And what we're looking at with our builder partners, they've all done very well. We're concentrated in the right market segment of that at the entry-level home. Each of the builders did very well in Phase 1, we're continuing to roll that forward. And really, what we want to try to do is if somebody finds themselves to be overweighted in that segment, that may be an opportunity for us to take some of those lots back and continue to invest in that single-family market.

So Yes, we are interested in doing that. Currently, all of our lots are under contract, but this is one of those opportunities. So you may see us continuing to invest a little bit more in that area in Phase 2B, C and D. So those are opportunities for us.

As it relates to share buyback, 1 of the things that the Board is very cautious of is we want to make sure that we have that optionality in investing in all elements of the company, water, land and our own currency. To the extent that the market continues to have a disconnect there, Can I attest to 200,000 shares -- 200,000 shares was picked because it was an anti-dilutive number, but it's -- we'll wait and see. As you've seen, and Bill, you've been with us a tremendous amount of time the stewardship and the governance that we have are very disciplined. We take a look at these things incrementally. We see if they're working and then where they are working, we continue to reinvest in those areas.

So this share buyback was very, very well thought through a number of quarters and it's an opportunity for us to continue to invest in our own currency so, so I can't give you any more specifics other than that. Other than you kind of see our past performance and our history of how we do things thoughtfully, carefully and then we continue where we see successes. So those are going to be our metrics that we continue to roll forward.

Q: Mark, how big a portion of your company, do you want to rental business to be.

Mark Harding - President and CEO, Pure Cycle Corporation

It's a good question. If you take a look at the 3,200 single-family lots out there, a good growth target would be somewhere around that 12% to 15% of that market can be in our portfolio.

Q: That's going to be a big business for you.

Mark Harding - President and CEO, Pure Cycle Corporation

That is going to be a good business for us. And much to your point. I mean, it is 1 of those things where that asset continues to appreciate. Our customer is paying down the vertical cost of that through the mortgage rentals on that. And then it also provides cash flow to us. So it's going to be 1 of those -- it is a win-win segment. And it's one that we actually have a reason to be in. If you take a look at us being in the business just to be in the business, I would say it's a good business to be in and a lot of money is going towards that segment. But given the fact that we are able to carry forward the equity value that we have in the land and the equity value that we have in the water, it's a highly tax-efficient mechanism for us to invest in. So we're carrying that forward and it's appreciating.

And so if it turns out that we find a great acquisition and we've got a few hundred homes that are out there, that can be an opportunity for us to spin that off and use that as monetizing for another land acquisition that might be a bit above our punching weight at the time and then continue to grow that back. So there's a real flex there for us on that business segment.

Operator

Our next question is coming from Geoffrey Scott with Scott Asset Management.

Q: Two questions. You didn't mention much about the commercial side. Can you talk about the development and potential timing of that.

Mark Harding - President and CEO, Pure Cycle Corporation

Great question. And we have -- we're continuing to build up on that residential side. The commercial segment, I'd say still a bit out. I think they're looking for about -- most of what we would be putting up there would be looking for about 1,000 rooftops in and around the area. We do have neighboring developments that do provide a lot of density to the equation on this thing.

And really, we're looking for the higher-value commercials there. We're looking for the big boxes. We're looking for the big -- not just a small grocery store, we want a big grocery store. We want big retail centers out there that are really high-volume stuff. And we also want to be opportunistic to be able to maybe partner on some of that, where we're able to bring the utilities and bring the land to the venture, much like we're doing in the single-family rental segment carrying forward some of that equity value.

We're not going to go vertical on the commercial as like we are in the residential. But we do have opportunities to take a look at that and high-value margins for us being able to do that. So it's still a bit off, and I think that our patients here is going to be well rewarded by bringing in some of that big, big commercial, not just some small retail commercial that usually does like to lead that and then they end up getting in some preferred positions because people really pull that trigger a little too early, and then a lot of times those sites get redeveloped, we want to really kind of be patient and develop that out as a big commercial opportunity and mostly because of our location, right?

Where we're located, we're located right off the interstate, we're located right next to the belt loop on it. We're just south of the interstate. So -- sorry, just out of the airport, and so that does pretend it's high-value use for large commercial.

So I know I've said we're being patient on that, and we continue to be patient on that. I don't have a start date on that, but we continue to be very active on pursuing market opportunities for that.

Q: If I understood correctly, the big box kind of people want a lot more houses built, right? So they wouldn't be in a community of multiple thousands. So we're talking about development kind of 4 and 5 years away from now.

<u>Mark Harding - President and CEO, Pure Cycle Corporation</u>

Yes, that's a hard one for me to say it's that far out. I'd say it's -- it might be a couple of years out, but not 4, 5 years out.

Q: Okay. Next question on page, whatever it was 26. You said you had 404.9 million gallons delivered. If my math is correct, that's kind of the 1,200 acre feet -- 1,300 acre feet, and you have 30,000. So you're selling, what, 3% to 4% of the acre feet that you currently have, why additional water acquisitions?

<u>Mark Harding - President and CEO, Pure Cycle Corporation</u>

It's really just where we can. Once the water is purchased by a city municipality, it's gone forever. And so what we're looking at is not necessarily expanding the portfolio just anywhere. We're expanding our acquisitions where it's next to areas that we're already invested with. And so we -- it's an opportunity for us to continue to build that portfolio.

We do know we're long on water. We don't want to be overly invested in that area, but we're where it's a strategic acquisition, we'd look to consider those. And it's a function of price. Is it a good price? Are we able to bring value with our infrastructure and our other water rights to that particular asset that really builds value beyond the acquisition cost of it.

Q: If I hear you correctly, it's really a defensive move to keep it out of governmental control?

Mark Harding - President and CEO, Pure Cycle Corporation

Not necessarily out of governmental control. I mean once -- the other water provider, so it's very competitive. So we have 70 different water providers who were all out scouring opportunities for water supplies. And so you have diminishing acquisition opportunities and an increasing number of folks that are looking for those acquisition opportunities. And so we're looking at making sure that we can continue to grow that side of the business through logical acquisitions.

Q: Okay. Anything happening then on the reservoir?

Mark Harding - President and CEO, Pure Cycle Corporation

No. We still look to partner with other regional interest on the reservoir assets that we have and whether that's with our neighbors or with our partners that we have in Wise with the South Metro Group, all of those studies, evaluations and smart consultants continue to take a look at that, but nothing really exciting to update you on.

Operator

Our next question is coming from Greg Malachowski with Benchmark.

Q: Just a couple -- mainly one general question and that kind of involves the single-family rental business. Has your approach to financing that changed at all with the -- I know the mortgage rates, you mentioned were in the high 3s or low 4s. Has there been any change in approach through how the company is anticipating funding future ones with the rise in mortgage rates? Or how are you guys evaluating that?

Mark Harding - President and CEO, Pure Cycle Corporation

That's a good question. It has. The opportunity for us, we did lock in maybe that $4 million at some very attractive rates, and so we like that, and we will continue to keep those out there. As mortgage rates have gone up to 7% because of we have such strong equity value in that, we may look at instead of financing 80% of that, we may drop that down a bit and finance maybe 50% of that. So it's -- we will still use that financing mechanism. And I'd say we're going to be indicative to everybody else.

It was better for it to be at 3%, 4%. It is not awful for it to be at 7%. And it's not always going to stay at 7%, right? This is the type of financing activity. And I think that that's where the millennials that are going to really be looking at buying a house. And they may be making the decision to buy a house for other reasons other than it's an investment or it's that there's a significant utility value in owning a house.

And so taking a 7% mortgage on a house is more traditional and more in line with the long-term projection of that. And so I'd say, yes, we do have an appetite for continuing to finance those out to the extent that we're getting 4%, 4.5% on that. We may be able to get a better return by financing some of those ourselves because that's going to provide more cash flow to the bottom line when we have those opportunities to do that, but we're not going to be overweighted in it either. We like to continue to grow that segment. Our Board has said that this is a great segment for us, but we want to be able to leverage the vertical cost of that. We're going to carry forward the equity value, but we want to leverage some of that vertical cost. And 7% is still a very good rate for us to view that as some of the cheaper money because of the mortgage type lending activities there. So you're going to still see us pursue 50%, 60% of that into the mortgage side.

Q: Okay. And how do you see the overall rental market right now and maybe projecting going forward? What is the strength or weakness associated with that versus kind of what you guys loosely would underwrite when you're looking at picking up a home.

Mark Harding - President and CEO, Pure Cycle Corporation

It's a great question, and it is strengthening. So what you're seeing is, to the extent that those former buyers that would be out there and maybe they lose the ability to qualify for the same house that they would have wanted at 4% compared to 7%, we're really getting a lot of referrals from our homebuilders to say, well, if you like the community, why don't you go talk to the developer who's got some units that are coming online for rental because it puts them -- it locks them into the market, right? There's that as a component of it.

And then the second component of it that I think we're really excited about is really bringing online our school, right? That's a sense of community. That's a sense of place. That's a sense of education being the initiative of every new subdivision, new community. And so that's a strong driver for new families, particularly because we're opening up this K7. It will be a full K8 facility. We may not open all those grades all at once, but that's what the capacity of that is. And so we find that to be some good traffic flow on the single-family rental business, which is kind of putting a little bit of wind in our sale on why we may partner with some of our builders to claw back a few of those lots and cells.

Q: Okay. Yes, because that's what I was -- so you're saying the financing is still favorable. The rental market is robust. So I guess if I can float something that maybe I'm sure you guys have thought of something that looks really attractive. You look at capital allocation and you've talked about the land, the problem with land is one, land still is by no means cheap at all. And two, as you guys are obviously aware, you buy the land and want it costs a lot of -- it requires a lot of capital to develop. And two, it takes a lot of time, so with what kind of is already on our plate, I'm not really sure land is the best use of capital at this point.

You look at the water rights and similar to the previous caller, it's nice, but when you're a public company in the market, just gives you no credit for the water assets you have, that might not be the best use of capital either. We've been over the back and one thing, I think, just in terms of looking at how you guys are approaching this, you mentioned investing in your own currency, but really, I think the correct way to view that is, if you put the first sale sign up and the company is worth, say, $25 a share, if you're capitalizing on an $8 print, you're creating immense value for the shareholders that continue to stay along for the ride. So you're doing that now, which I commend and I think that's great. And I think you guys should be aggressive at these prices.

But then you get into the single-family rental business. And again, it's like buying back stock where your basically able to create a $400,000 or $500,000 asset at a fraction of that cost. You own the land, keep the developer margin. And then on top of that, you have tremendous optionality with the financing. So let's call it, if you can put one of these things up for, let's say, $250,000, $300,000 and most of that you can finance with bank money, you're able to not only create value, but you're also keeping the momentum at Sky Ranch moving. I think one of the biggest and most important things in an environment like right now is keeping things moving in an efficient manner and even leading into the commercial keep the rooftops coming. So if there is a slowdown like you've mentioned and maybe some of the builders are -- they're not selling as many homes or whatever.

You guys could realistically take down 100 homes, and if you break out what that would actually cost you guys and then you back out the financing, even something like that, wouldn't be that expensive? Wouldn't cost that much money. You build the water business, you keep the roofs coming, and you'd also be making money doing that. So I think that this is really an opportunity where you guys should heavily evaluate stepping up the rental business because as you said, it's a win-win. And I was just curious if kind of with what I said, you had thoughts on that or followed along or where maybe you would disagree with any of that? I'm just curious because I've been thinking about that. It just looks like a no-brainer type of opportunity for you guys right now?

Mark Harding - President and CEO, Pure Cycle Corporation

Yes. No, I agree with everything you said. What I do and what we are looking at is working with each of our builders to say, okay, let's take a look at this next takedown. we're ready to move forward on this next takedown, and you guys find yourselves to be a little bit long on your longer than you think you'd want to be, then we can pull back, not pull back on the start, but we'll pull back some of those lots. Instead of having 10 in that next subsecond section of that, maybe we have 50. Maybe we pull back some of those and we can develop those or we can have them build on them the same way they would be building the next door and then just deliver that house to us.

And it's never been more relevant for them to have a guaranteed buyer. So that conversation is there, Greg, and we will take a look at something like that.

Q: All right. Yes, that's good. That's it for me. Just I think it's awesome. I think right now is where having been a conservative company being responsible with capital, you're going to win down the line by playing offense and being in a position to really capitalize on these things. So it's good to see you guys start looking that way. And the previous 12 months was excellent. So I'm excited about the new developments. And I think, again, you can look at the overall macro situation. But I think given what you guys control, I think it matters a whole lot less than people might think. So I'm happy to see you guys kind of looking at things through that lens as well. So take it easy and I look forward to the next call.

Mark Harding - President and CEO, Pure Cycle Corporation

Great. Thanks.

Operator

[Operator Instructions] Our next question is coming from Bill Cunningham, who is an investor.

Q: I actually have for starters, just a very basic financial presentation question for you. you earned $0.40 a share in the most recent fiscal year. The first 3 quarters were $0.17 a share, which I think means you had an absolutely fantastic final quarter of $0.23 per share. But it doesn't appear that you actually lay out anywhere the actual numbers specifically for the fourth quarter, unless I'm missing something.

Mark Harding - President and CEO, Pure Cycle Corporation

You're right, we don't. And I apologize for that because it's always helpful for us to take a look at quarter-over-quarter. In this particular case, and one of the things that the fourth quarter did for us that really boosted that up was the ability to -- well, liquidity wise, it was the ability to get that next bond offering from the CAB, the delivery of all those finished lots. And so it was weighted into the finished lot category.

So when we take a look at our builder agreements Three of the 4 builder agreements are lot delivery agreements where they pay us on that 1/3, 1/3, 1/3 principle. And the reason that, that fourth quarter, and it will always look like that on a quarterly presentation. It won't always be the fourth quarter, but it will always look like we'd get this huge weight because one of our builders is a finished lot delivery. They pay a premium for that. But that's why we'll always wait in one of the delivery quarters.

Q: Okay. I'm also looking at your Sky Ranch Co website, which it shows that 2 of the 4 builders in Phase 2 are simply coming soon, D.R. Horton and Lennar, so I'm wondering, is that actually updated that they're not selling homes there yet? Or what's the situation with those two?

Mark Harding - President and CEO, Pure Cycle Corporation

So Lennar has probably got -- I'd say they've got 2, call it, 10 town homes under construction. And I would say 6 or 8 detached single-family homes under construction. So the -- they just haven't opened yet as a for sale. They have a -- they're not doing sales trailers, they're going to be selling out of a model home. I think their model home will be open before, say, the holidays.

D.R. Horton is really -- they have yet to start out there. They were a little bit slow on getting their approvals for their home products through the county. So I think that they're set to get out there within the next 2 or 3 weeks to start their product.

Horton typically has a more aggressive build cycle on that. They build more spec homes than most, but we'll see what they do in this market.

Q: Okay. So with Lennar actually building homes, obviously, they've purchase tap fees from you, but they haven't sold the homes yet. And -- I mean, how many tap fees have you sold in Phase 2, I'm wondering about.

Mark Harding - President and CEO, Pure Cycle Corporation

Of the 230 lots, I think we've sold about 110 taps. That will give you an idea of the building permits that are in that.

Q: is there likely to be a lull then with -- it sounds like you've kind of got a -- you're ahead of the ball there with a lot of tap fees already being sold and for homes that have not yet been sold. So I assume there might be a bit of a low on tap fees in the next couple of quarters. Is that.

Mark Harding - President and CEO, Pure Cycle Corporation

Yes. If you're looking at a quarter-over-quarter, I probably wouldn't disagree with that. I try and caution you as well as the rest of the market that quarterly management of a company like ours is a little bit harder, but we still look at a great year, year-over-year.

Operator

Our next question is coming from John Rosenberg, who is with Lachlan Water.

Q: Most of my questions have been covered. Also, congratulations on your year and your results and your strategy. One of your last callers talked about -- questioned you and talked about your flexibility in moving more towards the rental segment as market conditions demand. And I just want to -- Well, first, I wanted to congratulate you on that segment and also ask you. So drilling a little bit more. So you have absolute flexibility in doing that.

Is there any cap on how much you can do that per period or.

Mark Harding - President and CEO, Pure Cycle Corporation

No, we really don't. And the reason we like it so much is that we have an advantaged to roll forward some of that cost. And so as Greg was mentioning, when we're carrying forward the equity value of the land and the water on that and really that's a tax-efficient strategy to be able to do that. And he's right. We're delivering a home that might be $550,000 home, if you take a look at the standard detached product base, and we've got a number of different categories. The reason we like really concentrating a bit more into the rental market here in the second phase is we've got 6 different product classes.

And so we're not constrained to just the same type of rental customer. Right? It can be just -- it can be an individual that comes out and is taking a look at a town home or a duplex. It can be -- we got duplexes together, and it could be a family with bringing, say, renting both sides of it, where the parents may be on one side and the new family would be in the other side. And you have great opportunities for them shared spaces and things like that.

So that's why we like, not only is that it's a great opportunity for us, but the diversity of the product mix in our second phase of this thing gives us a ton of optionality in what we're offering to the marketplace. It's not a homogeneous customer for us.

Q: No, that's great. I do appreciate that. And I think, yes, that was a very thoughtful move in terms of expanding your product range in Phase 2A. Additionally, just kind of a little bit of housekeeping. Your receivables from the CAB, I presume that's going to be very lumpy over time as needed.

Mark Harding - President and CEO, Pure Cycle Corporation

It is. It is. It's every a couple of 3-year cycles between the 2 as you start and you build up AV, each of these bonds have kind of 5-year call restrictions on that. They're really 3-year plus premium calls in years 4 and 5.

And as you do them, what happens is the AV, so the value of each of these homes continue to grow, and you have the same number of mills, so you increase your bonding capacity. So they are lumpy. I will say that our underwriters could not have been more complementary about our business model.

And they took a look at it, and we were in a tough, tough market where not so much in terms of the interest rate market, but a lot of outflows from invested capital for municipal bonds. And so when you have all that money coming out and you have deals trying to hit the market, we were oversold 400% on our bond offering. So it really is a validation of how we do it, the care with which we do, how we're investing in this infrastructure. We're maturing that we're not over our skis on any component of the infrastructure or the delivery of lots and we have great partners in our homebuilders.

Q: That's great. And lastly, again, a bit more housekeeping, but I seem to recall from a prior conversation that when you do ultimately go to large commercial and perhaps I'm wrong, you'll be eligible for other types of infrastructure reimbursement perhaps from the state? Or am I incorrect in that?

Mark Harding - President and CEO, Pure Cycle Corporation

You are correct. And the interesting thing about that is Colorado is what we call a sales tax incentive state. And so what we do is we weight the burden, the tax burden to the commercial base. So by a lot. I mean by 4x. So the same AV at the residential and commercial. If I take $1 million of AV at residential versus $1 million AV at commercial at the same mill rate, I get 4x the tax revenue on that.

And so yes, it supercharges your ability to get back your reimbursables even to the point where we would no longer have reimbursables. We would be -- we would have more bond capacity that would be able to fund -- forward fund some of those public improvements.

Q: And I take it then, if I'm hearing you correctly, that also means that would also imply to me that the cadence of reimbursement would be somewhat accelerated from where it is now, once you do start actual commercial development?

Mark Harding - President and CEO, Pure Cycle Corporation

Yes.

Q: Great. Okay. Well, thanks again. Congratulations and keep at it.

Operator

Our next question is coming from Greg Zena, who is a shareholder.

Q: just have 1 quick question about the rental. Is the product when you're building a home, let's say, a single-family home in an area of $400,000, $500,000, is the product identical to the other homes that are -- does it look the same? Does it have the same amenities inside the home?

Mark Harding - President and CEO, Pure Cycle Corporation

Yes. Typically, we do want to have it be consistent with what the other products are. They're not exactly the same because every homebuilder were owned their particular home plan, but it will be the same composition. So you're not going to see -- if we're in an area where we've got 2-story walkout basements, you're going to find a 2-story walkout basement -- if we're in an area of lab on grade crawl space, you're going to find the same home on that same block. So it won't be out of character to the blocks and to the overall community.

Q: Do you have any concern about the stigma , I don't know, let's say, it's Five years from now, I live in an area where developers were supposed to put in affordable housing in the neighborhood, and there was a stigma in the resale market that when something came up that -- well, this wasn't built by the builder this was built by -- and therefore, the valuation is not going to be the -- retail is not going to be different.

Mark Harding - President and CEO, Pure Cycle Corporation

Yes. And I think that's the reason we're careful with what the product class is. And then we also -- I would probably tend to argue that in a large measure, we have some control over maintaining these properties. And so even after we're out of the Master Planned Community, we're still in a position to maintain this number of homes. And if we execute the way Bill Miller took a look and called me out on getting a foreshadow of what we think the community might pose for us. If we've got 12%, 15% of 3,000 homes, that's going to be 300, 400, 500 homes in that area.

And so we'll have the ability to have enough staff to kind of maintain those properties. And so we will do that. We'll keep that for that very purpose. We want to have preferred rental pricing. We want to have good resale should we choose to monetize that particular asset.

So we're conscious of that. And now we don't want to be slum lord in this area. We really very much like this community. We're vested in the community. We want to continue to invest and continue to generate the returns on that asset. So good stewardship of an asset is the DNA of this company. And you see it year-over-year in what we're doing and how we're investing. And so I would -- I can't speak to what's going to happen in 20 years when I may not be at the helm. But certainly, the footprint of what it is that we're doing is to continue to invest in our assets.

Q: Are the laws in Colorado tenant friendly? Or are they landlord friendly?

Mark Harding - President and CEO, Pure Cycle Corporation

Good question. I think they're pretty consistent. The eviction process is pretty consistent. We haven't seen that. We haven't had that experience. But I would say it is probably landlord. I'd say it's neutral. It's not one or the other. It tends to be fair in the composition.

I'm thinking back to that Michael Keaton movie about that San Francisco product blanking on what the movie was, but the Nightmare Tenant. So far, we -- I don't think we have that.

Q: Yes, it's early -- in the single-family area, do people maintain their yards themselves? Or is there an HOA that takes care of the landscaping.

Mark Harding - President and CEO, Pure Cycle Corporation

No, everybody maintains their own property. Now some of the higher density like the townhomes and the duplexes do have a separate fee structure that does allow them to be maintained on a common maintenance basis. But the single-family detach are maintained by the homeowners.

Operator

Our next question is coming from Elliot Knight with Knight Advisors.

Q: I don't have a question, but I, as you know, have followed this company closely for 30 years. I have to say this has been the most productive Q&A session and presentation that I've heard. And I'd just like to thank everyone.

Mark Harding - President and CEO, Pure Cycle Corporation

Well, thank you. The nice thing about it is you don't say -- we don't -- you know our personality. We don't really take bell lapse here. At the end of the day, I think what you've seen, and I think what everybody is really catching up on is kind of the discipline that the Board and management have on kind of continuing to do the right things, test the market, reinvest in those things that are working, modify those things that need some modification. And so we're very thrilled to have this kind of liquidity moving into what will be an interesting market.

I don't think that there -- this overall interest rate market is recalibration more than it is anything else. We've got macroeconomic indicators that are much different than maybe what we saw in 2007. But more than anything, we have the ability to -- we have strength going into it. And so we're thrilled. If this presents an opportunity for us, you're going to see us take advantage of.

Q: I have seen you take advantage of things in the past. I have every confidence, Mark, that you're going to do it and you just keep up the good work.

Mark Harding - President and CEO, Pure Cycle Corporation

That's on the back like that keep me going.

Operator

Thank you. First, at this time, there appear to be no further questions in queue. So I will hand it back to Mr. Harding for any closing comments you may have.

Mark Harding - President and CEO, Pure Cycle Corporation

Terrific. Well, I'd like to again thank you all for your continued support to the extent that you didn't get an opportunity to bring in on a technical challenge, please don't hesitate to give me a call. I'd be happy to drill down on any of the specifics and continue to stay tuned. We have some exciting things that we're working on, and we'll look forward to executing and bringing those to increasing the value for all of our shareholders. So with that, I'll sign off, and thank you all.

Operator

Thank you, ladies and gentlemen. This does conclude today's conference call. You may disconnect your lines at this time, and have a wonderful day. We thank you for your participation.

Mark Harding - President and CEO, Pure Cycle Corporation

Thanks, Ali.