Transcript of
Pure Cycle Corporation
First Quarter 2023 Earnings Call
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Participants

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Presentation

Operator
Good morning, and welcome to Pure Cycle Corporation's First Quarter 2023 Earnings Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] Please note this conference is being recorded.

I will now turn the conference over to your host, Mr. Mark Harding, President and CEO of Pure Cycle. You may begin.

Mark Harding - President and CEO, Pure Cycle Corporation
Thank you, Jenny. Good morning, everyone. I'd like to welcome you to our first quarter earnings call for fiscal year 2023, and happy New Year to you all. We have a slide deck for this, if you can surf over to our website at purecyclewater.com. On the landing page, you'll find a button on there where you can click on that, and then we will actually forward through the slides, it will give you the ability to see some of the text and the slides within the presentation.

So with that, I'm also joined today this morning by Kevin McNeill, our CFO; and Dirk Lashnits, our Vice President and Director of Land Development, who will also give you updates into some of the business segments and the financial reporting. And then at the end, we'll have a brief Q&A for those of you who want to drill down on some of this specific.

So with that, let me first start with our safe harbor statement, which I'm sure most of you are familiar with, but statements that are not historical facts contained or incorporated by reference in this presentation are forward-looking statements. So with that, we get the lawyers out of the room, we'll start I'll just be very brief on some of the overview of the company. But for those of you that are first timers, so the call or new to the company, we really operate on 3 primary business segments really that are fundamentally interconnected to each other at the DNA level of the company.

We're a water and wastewater utility company, where we own water in a water short region here in the state of Colorado and the West. We develop those water rights, and we are cradle to grave on the water rights where we develop the wells, the distribution system with that water to use in both the Land segment, which is a parcel of property that we own that we're doing a master planning community on, and we're building lots for our homebuilder customers. And then we are holding back some of those lots and building homes on those for single-family rental segment as well, so each of those segments really are interrelated to a vertically integrated platform that we have from the water utility side.

Moving onto just describe a little bit briefly about the Water segment itself. We have just that whole network of utility operations where we have the diversions for the water supply, whether those are taking water sources from our streams and surface water supplies, or groundwater supplies, or reuse supplies. We treat that water we store it. We distribute that out to our customers, we're also responsible for some of the development of that distribution system pursuant to our design standards for our community, which is some of the lands that we have, but others as well. So we have master planned service areas that are very valuable, which we will highlight a little bit later in the presentation.

Our customers use that water. They give it back to us. We collect that. We treat it and then we reuse it. So we have a use and reuse model. Within that we get some fee instruments for that, and the water utility side we get connection charges, which are a one-time connection fee, which between the water and the sewer tap fee around $30,000 to $33,000, and those are paid by the home builder or home builder customers. And there's a typically added into the cost of the home. But that grants the service connection, a permanent entitlement to the water supply. And then we get usage fees for that.

So we get a base fee, which really amortizes some of the cost of operating and maintaining a system. And then it can consumption charge, which is a tiered consumption charge. And so what this tends to do is that tries to encourage conservation, because the more water you use, the more water – the higher the cost of the water supply.

So as you take a look at our water balance, what we like to do is really keep control over that drop of water. We're taking that from the supply, we're treating it, we're putting it into our system, we're getting it back from our system, and then we're reusing that. And so we do have a very closed loop system, we do lose a little bit to outdoor irrigation and some evaporation, but those trends are really decreasing and there's been a lot of press, I'm sure something much of you have seen about drought and the vulnerabilities of water supply on the left. So the company's emphasis on technology and controlling that drop of water through its continuous lifecycle is very important to our systems. And we want to make sure that we're good stewards of this water supply.

Taking a little bit of the infrastructure, we build this infrastructure, it's long lived assets. Water supplies certainly are long lives. Those are perpetual. And then you have a lot of the brick-and-mortar that we're building associated with that. And really, this is showing the growth of the company in the last 5 or 6 years really showing about an 86% growth in the capitalized assets class and the various categories of that infrastructure, whether that's water and wastewater treatment facilities, transmission lines, wells, finished water storage, surface water, groundwater supplies, distribution systems, those all the components of a water utility, you'll find in that. So that'll continue to grow as we keep seeing that.

Moving into kind of how the growth of the utility looks like. Our current customer count is up to about 1,250 new connections. We measure that in terms of the number of single-family equivalent connections on that. And so we have a combination of residential customers, which would be a standard single family equivalent, but then we also have commercial and irrigation connections attributable to those. And so just because you might have one irrigation connection that might represent as many as a couple of hundred, as we see down in Lowry, because we have large irrigation requirements down there of connections. And we raised that to the number of how we build those out. So the number of base charges that we get for each of those.

Talk a little bit about our residential connections at Sky Ranch, which is our development, we have our first phase, which is completely built out 500 homes. We are into our second phase, very robust tap sales in our second phase. Dirk will drill down into that a little bit, but we got 124 taps there. And then a service area that we picked up a couple of years back, where we have more than 200 connections between the residential and commercial connections as well.

Moving on another one of our big customers on the utility side is the industrial space, where we sell a lot of water to the oil and gas industry through a number of different operators, and our water supply or service areas, and really the state of Colorado is located over a fairly prolific oil and gas field. It's gotten a little bit more attention more recently with the shale oil play. But we are seeing operators drill a number of pads, and a number of formations here that consume a tremendous amount of water for oil and gas.

And so we continue to see those sales. This is a distribution of how those sales go by quarter. And as you can see, it's kind of all over the math. There's not a lot of predictability to it, they drill year round, they track year round, and a lot of this is really dependent on a permitting process and how aggressive they are. The leasehold interest in this – and particularly in our particular field has changed hands a number of times, which is pretty typical in the oil and gas industry. But it started out probably in 2015, 2016 timeframe with a lot of the field assessment and field definition. And now it's kind of moved into more of a well development. So they're developing the field so that they don't do a lot of exploration, they don't do a lot of changing to it.

So each rig has a much stronger capacity to drill more wells per pad per year. And so what we're seeing is, when you get a dedicated rig out here that can drill as much as 25 to 30 wells a year. And there are pretty significant wells there. There are 2-mile lateral wells on this thing. I think they're experimenting with some 3-mile lateral wells on it. And so they'll continue to increase the amount of water that they're using depending on their laterals on.

This is kind of illustration, if you look at the right hand side of this, that'll be kind of a Denver metropolitan area and kind of the growth in the metropolitan area that two red areas or pink areas that you see in there. Those are our service areas. If you look at the one kind of transition between the green and the gray there that's our Sky Ranch project, which is ideally located just on the I-70 Corridor. And it really is in the strongest area of growth in the Denver metropolitan area. And we as a develop are really targeting the entry level housing product, which I think endures very well for us both in very strong markets as well as in challenging markets, and so we'll talk a little bit more about that.

And then our service area at Lowry is a very large pink area, which continues to be really an untapped asset for us. The land is owned by the state of Colorado and trust for the public education system here. And it's one of the most unique assemblages of land in the country. And as you can see by the picture on the left there, most of the development has really come up to the border of that property. And so it depends on how the state looks to move forward with that, but that's certainly an opportunity for us over the next few years that that we look forward to doing the utilities for that we're the exclusive water and wastewater provider for that 24,000 acres of contiguous property.

That gives you kind of a sense of the utility side, some of the segments that we have in there. I'm going to hand this off to Dirk Lashnits, who will talk a little bit about our Land Development activities.

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

Thanks, Mark. Good morning. Land Development, so here's our flagship project called Sky Ranch. Every time I see it, in its overall view and always reminds me of the dreaded Tetris piece from that game. But this is 930 acres, like Mark said, on the developing edge of development out on the East side of Denver has 3,200 residential lots capacity, and 2 million square feet of commercial capacity, and we're about 15 miles East of downtown Denver. Sky Ranch, it's probably got about a 10 to 15 year build out that will be heavily dependent on our market conditions, we're going to build this out in multiple phases. Over the last probably 4 or 5 years, you've heard us talk a lot about our first phase, that's the first 500 lots that's pretty much in the books.

And we're now moving on to our second phase, the first phase is the block on the left side of the picture, and then our second phase is kind of the middle portion of the parcel and then future phases will grow out to the east. And then our commercial piece is, the northern block adjacent to I-70. We plan to build about average probably about 250 lots per year out here. And we'll layer in our schools, and commercial pieces, and rec centers, all those things that go along with a master planned community.

So phasing, as I mentioned Phase 1 in the books that was 500 lots, we have had our pilot program for our build to rent lots. So we have 4 occupied units in that phase, 100% complete, then moving into our second phase, this is 850 lots, we're subdividing this into 4 sub-phases that's 2A through 2D. We are well underway in our Phase 2A that's about 80% complete and hope to have that completed later this year, beginning of 2024. We've started our infrastructure for Phase 2B. We'll hoping to start that in earnest quarters 2 through 4 this year. And then phases, the third and fourth sub-phase 2C and 2D will build out in subsequent years.

Our Phase 2A, we just had our first few residents move in there that's exciting. We have delivered all our lots to the builder customers there. As you saw by our water taps number on previous slides. Those are indicative of the number of homes that have builders have started. So right around that 120, 130 houses started and take the builders have sold probably about 20%, 25% of their lots and they will look to have those sold out the remainder of this calendar year, and then we'll be looking to have that second phase come online for the next batch of lots to not interrupt that sales cycle.

All right, so this is the details on the phasing. This is the Phase 2 850 lots broken down into 4 sub-phases. We got our lot revenues, those numbers are what we are income from sales of the lots to the builders. Then we have our tap revenues those are the water and sewer connection components that Mark mentioned. Then we have our costs to develop the lots. And then we have our reimbursable components. And those are the costs attributable to public infrastructure that are eligible for receivable reimbursement through public dollars, whether that's taxes or more bonding.

The graphs on the bottom of the sheet here, the bar graph, and then the far right pie chart those are our builder breakdown, builder distribution. So we have our four builders in this phase, and that's by builder. And then that center pie chart is our product mix. So those 6 slices of that pie represent our different product segmentation, which gives a good balance of product offerings and provide good diversity.

All right, [talk to] [ph] some market conditions here sort of the news of the day, start with our good, so the positive things pent-up demand for new home sales. We think there's good upside here. Back in the 2005 or 2006 timeframe, there was about $1.4 million in home sales and even in this latest upswing in [2001 or 2002, or 2021, 2022] [ph] we're only at $600,000. So I think that represents good upside for us. In this first quarter, we've seen the mortgage rates start to stabilize they'll kind of hovered around 6% that's in historical norms.

Lot deliveries still trailing home starts. So in other words, we are still selling more homes than we are delivering finished lots. So from our standpoint being in the business of selling lots that's good potential there like to see that demand, our homebuilders in Sky Ranch are all ranked nationally, all four in the second phase are in the top 15, I think 3 of them are in the top 10, 2 of them in the top five.

Yeah, it's top 1, top 2 even good for stability in it for the long haul. They've certainly seen some of the market swings and are good partners in helping mitigate that low unemployment. This is obviously a really important one, we hope that stays positive. House prices still appreciating, buying a house still a good investment, lower average days on the market. Houses are still selling pretty quickly. And those are some typical numbers there that – last year, we were down in Denver at least, we were under 10 days on average in houses we're selling above asking price, sight unseen day of asking. So a year ago we had that peak, and even today with some of the slowdown, we're still seeing days on market in the 2020s, so that's all still good outlook.

On to the bad or opportunities that we have here, again, the abrupt uptick in interest rates kind of shocked the system. And I think we're slowly adjusting to that. Again, we're still in kind of historical norms, a lot of the important metrics still trending downward, builder confidence is down, applications for mortgages are down. Buyer traffic in the model homes is down, home sales are all down, and then combine that with higher material and labor costs. And then our cancellations on contracts are still up.

I think at the end of the day for us that houses are too costly. We need to figure out ways to kind of recalibrate that. The land development side that we do is the link in that chain and how do we adjust for those changing markets, and the way we do that is mostly on timing from a timing standpoint, and that's really our challenges is trying to time our deliveries. We have a long lead time in development business, we're probably anywhere from the earliest 6 months, but more likely a year out from when that demand comes online. So we have that challenge on trying to find the right time to build our lots. And here's just a slide is like a couple of the touches on the job growth chart, interest rates, and some sales information.

Back to Mark.

Mark Harding - President and CEO, Pure Cycle Corporation
I'm going to push this over to Kevin, and they'll give you an update on some rental segments, and also just a brief stats on the quarterly performance.

Kevin McNeill - Vice President and Chief Financial Officer, Pure Cycle Corporation
Well, thanks, Mark, thanks, Dirk. Yeah, so our single-family rental our newest division that we launched in 2021, we continue growing it. We got four houses completed now as of December 15. We've got 10 more under construction, and those will be delivered throughout our fiscal 2023, right? The four that are rented are all rented from $2,800 a month to $3,000 a month, pretty stable renters we think. So still we're very optimistic about this market, or this new segment, especially with interest rates continuing to climb, with home values continuing to stay high. And that's slowing of that market. Rental rate market in Colorado, especially remains very strong.

This is some projections that we put together using our fiscal year from last year our 2022 results, just because the first quarter is smaller piece to look at we projected out with 14 homes and 50 homes. 50 would be the entire Phase 2 46 homes there and 4 homes in Phase 1. And so what you can see is our current projections, obviously, depending on costs and interest rates, and everything else is about $1 million a year just short of $1 million a year in free cash flows from operations of just the rental units doesn't include obviously overhead or anything like that.

The financial results for the quarter wasn't the strongest quarter, we've obviously had – it was from water and wastewater standpoint, as Mark touched on earlier, we continue to invest in the water infrastructure little over $67 million now in water rights between asset water rights themselves and supply infrastructure that to bring the water to our customers. We delivered about 67 million gallons this quarter, which is down a little bit from last year, which is predominantly down, because there wasn't a lot of oil and gas activity during the quarter. And also construction activity was down so the with the Phase 2A being done and 2B not really started yet. It didn't sell as much water construction activities.

Dirk, obviously touched on the Land Development side, which you'll see when we get to the balance sheet and income statement as well, and in the single-family rentals continued to grow.

From a graph standpoint, you can see obviously the revenue and segment revenues were down for this quarter compared to each of the last few quarters. One thing I'll point out is in that Q1 2020 quarter that was kind of anomaly we recognized a bunch of revenue in that year to catch up some contingencies that we had and also there was a big, there was a lot of lot sales out here. Phase 1 was going very strong. Phase 2A was getting ready to start, so it was a great year.

This year you'll see the revenues are down predominantly again because we talked about the housing market slowdown. We delayed a little bit of Phase 2B in order to match our lot deliveries with their with the homebuilders sales so that that was somewhat intentional, but obviously with the housing market interest rates that was hard to control.

From a net income standpoint, you see the same thing that income dropped during the quarter first quarter compared to the other quarters. Same reason revenues are down we were able to offset some of the revenue declines with about a little over $1 million in surface use and other payments from oil and gas companies, which we think is pretty strong indicator of a good 2023 We hope for fracking and drilling continuing out throughout the rest of the year and through our service area. And then, obviously, there's our diluted earnings per share.

There'll be a little more information on this coming out when we actually filed the Form 10-Q, which is due in about 4 or 5 days, which we just made filing here in the next few days. [A few upcoming dates] [ph], we have our annual shareholders meeting tomorrow, which is – there won't be any big presentations here more of a formality. So not expecting a big event for that I tend to like, the filing date is January 17 that we filed before then. And if you haven't seen it our ESG report we've launched in November. So that's on our website gives you a little more detail on our what we're doing from an environmental standpoint, how we're trying to be good stewards of the environment, and see shareholder money.

And then real quickly, the balance sheet income statement, see we had a pretty good pickup in cash last year. The Sky Ranch cap did a bond offering and was able to repay about a little over $24 million and told us of reimbursable. And so we invested that in some short-term treasuries and capitalize on some of those interest rates continue to grow the balance sheet in terms of assets and investing in new water rights and infrastructure. And then you'll see the income statement, obviously, I won't spend a lot of time here, it will come out in the queue, and in the press release we issued last night, as a lot more information on it.

But you can see the revenue decline that we discussed predominantly in the land development lot sale area in that commercial water sale area. Our overhead stayed fairly consistent. We're keeping our headcount strong and then see in that other net $1.2 million of other income that was basically surface use payments and anticipation of future drilling and oil and gas operations on our land.

I'll turn back over to Mark for closing statements and questions.

Mark Harding - President and CEO, Pure Cycle Corporation

Thank you. Okay, so what are our takeaways here? I guess, takeaways for management would be kind of the stewardship of how we handle our business models. We've got very valuable, very low cost basis legacy assets here, both in terms of the water and the land side of the equation. And what we've done successfully is really make sure that we carefully position you all with your invested capital to market exposures. So one of the ways that we do that is through how we handle our builder contracts, and those of you that are familiar with the company kind of had this appreciation.

But we have a lot delivery agreement structure where our builders are working in partnership with us on delivery of this very expensive infrastructure.

We're in a high cost business, where we're delivering horizontal infrastructure for master planned communities, and then the housing side of it. The vertical sides handled by the home builders, but that infrastructure is very expensive. And we want to make sure that neither we nor the builders, our builder partners have too much exposures in software markets. And we're in a software market right now. And really the validation of that business model is the fact that we don't have any exposure in there, right?

As you saw in the presentation, and Dirk highlighted, we've got about 15% of the Phase 2B, which really would be the grading and the overestimation components of that that we've invested in. And that's been covered by our homebuilder customers. So that's not a significant investment in there. And then as their lot deliveries and this is about pace, right? This is about how many lots they want to have in inventory, because they want to match their sales cycle. And maybe in Phase 1, each builder was doing 7 to 8 homes a month. So that absorption was pretty high.

In Phase 2B, we're seeing maybe 3, but we are still seeing that, and 3 homes per builder. So that gives you a cycle for that. We find ourselves in the right market segment that entry level product. And so as the homebuilders come out there and look for buying opportunities to really highlighted continued demand for single family homes in the marketplace. And that's still we're seeing that in the marketplace. We're seeing that in terms of the builders and the building permits that they're pulling and the spec homes that they're building out of Sky Ranch, and then also that they're having sales that we've got customers that have moved out there in the last 30 days and continuing to really see that absorption.

We continue to invest value into the community. We're opening up our school, which is going to be a tremendous asset for them, because it's a local school, charter school that we partnered with a national charter operator out of Michigan National Heritage Academy, and they have a website, the Sky Ranch Academy as a website, you can take a look at that, but really good delivery device for education for new families out there.

And then taking a look at kind of diversity, one of the things that we like and Kevin mentioned was single-family rental business, there's still a ton of demand for more space at your home, because of the work from home balance, you're seeing a lot more dual income families looking for more space so that they can have offices at home. And our home product, we've diversified from either a 45-foot lot or a 45-foot lot in Phase 1A. And now we've got 6 different product categories. And that's enduring very well to the market segment. You have 6 different price points in there, as opposed to just a couple of price points depending on finishes.

So a lot of those design features that we add in our master planned community really is enduring well, and we'll stand the test in both good markets as well as headwind markets. And then ultimately continued sales of water in industrial operations, and so we're going to see a little bit of uptick in oil and gas demand, but that's really a [steady-eddie] [ph] customer for us. And we like making sure that we supply that segment water supply, and then can convert that water supply over into the potable supply. So there's a really good balance and how we're extending and developing into these assets.

And then continued growth, we continue to grow the company, small tuck-in acquisitions of assets. As you've heard me talk about in prior acquisitions, we're on the hunt for more land and really kind of build our land portfolio, don't have anything really substantive to talk. So I'm going to fore check some of your questions on, what's the update on acquisitions for land development. There are a number of opportunities that we're pursuing. And we're very aggressive about being doing that.

And one of the nice things we have is, we can be aggressive about that. We have a very liquid balance sheet, we've managed this capital, well, we've been disciplined with our board to be making those investments, and then also making investments in ourselves with the stock buyback. So those are kind of the capital allocation structures for us.

So with that, I'm going to turn it over to the lovely Jenny in Scotland, who's waiting for her lunch and see if there's any questions that you might have on drilling down some of the details.

Operator
[Operator Instructions] Thank you very much. Your first question is coming from Robert Howard from Boiling Point Resources. Robert, your line is live.

Q: Good morning.

Mark Harding - President and CEO, Pure Cycle Corporation
Good morning, Robert.

Q: Hi. I just had a quick question on the – for the new customers that are getting added on, so you talked about $1,500 of annual revenue from the water customers when they come on. I was just wondering at least maybe a Sky Ranch as you're adding customers and how much additional costs might there be. So are the – is the infrastructure and kind of everything in place. So that $1,500 is really kind of almost all incremental or is there additional costs that kind of get layered on as you're still kind of building up stuff. Or if you kind of reach a critical mass where maybe the costs are decreasing a lot slower than they were earlier in the project?

Mark Harding - President and CEO, Pure Cycle Corporation
That's a good question. And really we segment some of that brick-and-mortar cost for adding those connections into the tap fee charges. So typically the way we see it is the connection charges that $33,000 for a tap fee charge. We build the wells, the treatment facilities, all of the brick-and-mortar stuff that they deliver that water to the customer through that capital allocation base. And a lot of that is early on investment that we've had and then also what we see is the oil and gas revenues tend to allow us to expand that system apart from the tap. So the way we usually look at it is that's a 50% margin business. But it becomes a little bit better margins, because some of the oil and gas revenue, we can allocate to expanding that supply side in advance of those tap connections.

When we get the actual connections, the $1,500 connection per year, which is really your point. There are additional costs on that, because we have an operating entity where we've got chemical costs to make sure that we disinfect the water, we add lab costs, because we have to continuously sample our water and make sure that our water meets all of the primary and secondary clean water standards. So that business we typically also look at as a 50% margin business and it's not so much on the capital side as it is on the operating side, right?

We have operators that are making sure that they're going out, making sure the system is operating correctly, taking a look at whatever is occurring, daily, nightly, weekly on those sorts of things, in addition to really the lab costs, but that's how that divides out. There's not a significant uptick in that. And matter of fact, it's usually a little bit better on the front end, because everything's brand new, and it operates the way it's supposed to. But we really look at those margins is about those 50% in each segment of that, if that answers your question.

Q: Yeah. Sure. And then just that $1,500 number, I think you guys have kind of been talking about that for a number of years. Is there pressure on that? Or I know as the market rate elsewhere in Denver or other people charging that amount? Or is there possible pressure for that going up just inflation in general? How are you able to kind of keep the customer rates flat?

Mark Harding - President and CEO, Pure Cycle Corporation
Yeah. And I would say that there's two rates there. So there'll be tap fee rate, and then the usage rate. The tap fee rate probably has a little bit more upward mobility just because of the scarcity value, and as you continue to hear about the competitiveness of water rights, and the incremental costs, because we have to go farther and farther out to reach for those water supplies. I'd say our tap fees have a little higher upside than, say, necessarily the usage rates.

The usage rates will continue to grow, we continue to grow those for making sure that we keep up with our inflation costs as well as anticipatory costs for whatever the evolving regulatory climate is going to look like. But that's a little bit more inflation oriented, as opposed to the value of water in water short areas and the cost of water, acquiring those water rights from farther and farther areas.

So when you take a look at those two revenue streams, there's probably a little more strength in the tap fee side, which is going to be our big number. You apply that to our portfolio, we have 60,000 connections worth of that, so that's over $2 billion worth of revenue potential over time as opposed to that $1,500. That's been a stagnant number. We're probably a little bit above that. That's just been a metric number that we continue to look at. I would say that that continues to go at about 3% and 3.5% per year.

Q: Okay, great. That's all I had. Thanks a lot.

Mark Harding - President and CEO, Pure Cycle Corporation
Thanks.

Operator

Thank you very much. Your next question is coming from [Bill Cunningham] [ph], who is a private investor. Bill, your line is live.

Q: Hi, Mark, how are you doing?

Mark Harding - President and CEO, Pure Cycle Corporation
Just living the dream Bill.

Q: Good. On the last conference call, I had made the comment about the unusually good results, which is a result of lot sales and tap fees, and we talked about how earnings are lumpy. And that so we might not see the same in our results in quarter-to-quarter, and this quarter proved exactly, what you were talking about, I kind of did some penciling out of things ahead of time to kind of figure out what your numbers might be and thought it was 50-50 as to whether you'd be reporting a loss or a profit this quarter. So it was kind of a pleasant surprise that you actually squeaked through with a bit of a profit. So hopefully nobody else was surprised with the results being not as good as the prior quarter.

Mark Harding - President and CEO, Pure Cycle Corporation
Yeah, that's true, Bill. It's cyclical in a couple of ways. I mean, one, because of the way our year end reports, puts us into – we – and where we report, right? I mean, Denver, as most of you all found out. Denver is a great place to live. Except maybe December, January, February, and so cyclically we have and we're in the outdoor business, right? So a lot of our water supplies, outdoor irrigation, and outdoor land development activity, outdoor sales for single-family homes are all cyclical in the winter months. So it is pretty predictable. We are grateful that we were still able to be profitable and we will continue to strive to do that quarter-over-quarter.

Q: I do have a couple of particular questions for you. One is, I was looking at the tap fees sold and the totals. Your 10-K at August 31 said that 618 taps had been sold in Sky Ranch. Your press release said four more were sold this quarter. But then you reported a total of 766 taps that have been sold so far in Sky Ranch. So I'm confused on the difference between the 766 and the 622.

Mark Harding - President and CEO, Pure Cycle Corporation
Yeah, and really what we – and this was a real strong push to normalize the number of tap connections. There's a difference between the residential connections, and then we have the tap, the governmental entity that's responsible for the parks and the open space and the outdoor irrigation. And they pay a tap fee, but there are only one connection and so that's the difference. So what you can report the number of irrigation connections, that's a higher number. And we've been really trying to normalize that for everybody, so that people like you really drill down into numbers can get a feel for that $1,500 per connection per year amount. What does that apply to? And that's now we're really trying to give you all a little more clarity as it's applying to that 1,246 number of connections.

When we send out a bill that's not 1,246 bills, because there may be one customer that might have 50 of those connections, but that equates out to the same number of connections. So that's what we've tried to stick. I was figuring what I went through that statistic this quarter, I'm like cutting out who's going to call me out on this thing. [Actually we did] [ph]. I appreciate that. But we did that with you in mind specifically for the detailed orientation as well as Robert, who came back and said, okay, I'm really tracking this $1,500 per connection. And we really want to give the market a better clearer understanding of how to compute that number.

Q: Okay, great. Thank you. And then I also have some questions on the different builders in Phase 2A. And there seems to be a big difference from builder to builder as to what they're doing there. I mean, KB looks like they're going gangbusters where they've sold 27 homes already, which I think is about two-thirds of their total. And CHALLENGER with their homes seems to be doing okay. Also LENNAR has just started selling their single-family homes, but their townhomes are still listed as coming soon. And then D. R. Horton, we had talked about last quarter, where I guess they were having to do some revisions to their building plans with the county and hadn't started yet.

So I'm just wondering what might be going on with a couple of the laggards here with LENNAR townhomes and the D. R. Horton homes.

Mark Harding - President and CEO, Pure Cycle Corporation

Those are the two largest builders that Dirk was referring to. And, I'd say, they all kind of look at their own scheduling. And this is new for both of those builders. This is kind of a new project that they're in. And I think LENNAR has got, they've probably got other townhomes, they've probably got 18 spec townhomes under construction. So what they're really both of them more than LENNAR than D. R. Horton are really pushing for this seasonal downtime, where they can build and then hit the market in kind of March cycle with a ton of products. And they like the product that they have, because it's very price sensitive product, those townhome products are going to do extremely well.

And, I think, what LENNAR's forecasting is we want to have a good inventory of those. I think we showed some aerials of that. And if we didn't do it in the earnings presentation, jump on the website, because we throw up a lot of our drone shots on that you can see the bulk of the starts and the numbers out there. And I think we've got more than maybe 60, close to 70 vertical construction out there, our homes out there.

And, you're right KB has done very well out there, because they've got a pair of product. Again, that's higher density, better price points out there, challenges very competitive on their price. And then Horton, they're pulling lots of taps. So we know that they've got lots of building permits that they've got teed up and then they're just going to line build. They're just going to throw everything they got at it and do it all at once. And that's pretty stylistic for the builders.

Q: Okay. Yeah, that's great to know that LENNAR is actually building the townhouses right now, because just looking at…

Mark Harding - President and CEO, Pure Cycle Corporation

Yeah. They're very aggressively building them.

Q: Wow. Okay. That's great. Because when you look at the website and see coming soon, you just figure that nothing has happened yet. So…

Mark Harding - President and CEO, Pure Cycle Corporation
I think they've got [4 or 6 taps] [ph]…

Q: …under the news.

Mark Harding - President and CEO, Pure Cycle Corporation
Yeah. Yeah.

Q: Okay. Great. Thank you very much, Mark.

Mark Harding - President and CEO, Pure Cycle Corporation
You bet.

Operator
Thank you. Your next question is coming from Bill Miller, who's a private investor. Bill, your line is live.

Q: Hi there, Mark.

Mark Harding - President and CEO, Pure Cycle Corporation
Good morning, Bill.

Q: Happy New Year. And I wonder where we are with two things. One, you at one time indicated you might buy back some of the lots for the bill to rent part of your business? And secondly, where do we think we are with the I-70 development, which to me to be sometime near-term? And I wondered whether you could give us any indication of how soon that might take place.

Mark Harding - President and CEO, Pure Cycle Corporation
In terms of the buyback and some of the other phases of the lot, we're moving forward with Phase 2B, we're recording our flat this month, and then we'll get a sense from the builders. I think the builders were really helping to wait to see how their traffic activity was going to look for the first part of the year. And so we've reached out to each of them, and let them know as you look to your close, if you have. If your absorptions extend yourselves out a little bit farther than you would otherwise want to inventory, we will pull up whatever number of lots back from that. So all four of our builders have that offer, we've made that offer to them, they're all under contract, so I've got to work with them on their cooperation.

But I'm pretty confident we're going to claw back, not [claw back] [ph]. We're going to be invited back and a couple of those from some of the builders, because it's a win-win for them, they cannot close on that lot. And then we're talking with them specifically to say, but you can still build a house on that. And so that's an opportunity for them not to have, it really is a win-win, right? They can manage their cash flows. So that they actually can still show positive sales on Sky Ranch, to a customer that they know, and they understand which is would be us as opposed to waiting for traffic and contracts and cancellations. This is a great opportunity for both us.

And then to really continue to build the portfolio and we're seeing extremely strong demand. Every time we finished one of these houses and we put it up, it is gobbled up. I mean, we put it out on Zillow, and it's just we get competitive people looking for rental on this stuff. So we still are very aggressive. We still like that segment. We're moving forward into that segment.

The question would be, well, can we do more in another phase. Get out of the 850 and start another phase, we can. But that puts us in a bit more exposure, where we're actually inventorying all those land development opportunities. And we do have a balance sheet that can do that. But at the end of the day, we're also balancing that against opportunities for acquiring other land and making sure that we continue to build and grow the company. So there is a balance there.

Second question in terms of the Land Development side on the I-70 corridor, I think, you're probably referring to the Lowry project. And we continue to see a lot of pressure for entitlements. Everybody wanted more and more finished lots in the marketplace up through what was this interest rate environment and us being able to time the market where we're delivering lots, not throwing 850 lots to builders for them to inventory. But doing this on a cyclical basis, where they're helping us pay for that pull cost as well, certainly, is a proven delivery model for land development.

We'll see with the weakening of housing, how that cycle comes into impact, Lowry's timing, and other land developments in and around Sky Ranch that we're also looking at acquiring. So we're cognizant of all those elements. Our crystal ball isn't any clearer than the market, probably even glad to hear than some of the experts in the market. But what we tried to do is make sure that we're making informed decisions with our capital allocation plan.

Q: Well, what about buying back stock under those informed decisions?

<u>Mark Harding - President and CEO, Pure Cycle Corporation</u>
That's a great opportunity for us. And if the market continues to frustrate that stock price, we're there now. We're ready to do that. Do I have an answer for you? What price do we buy stock, I don't know.

Q: Okay. Sounds good. Keep going.

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

<u>Operator</u>
Okay, we have now reached the end of the question-and-answer session. I will now hand back over to Mark for any closing comments.

<u>Mark Harding - President and CEO, Pure Cycle Corporation</u>
So in closing, I guess, I want to continue to thank you all for your continued support and confidence in our business, our business model and our team here, I want to recognize and give a shout out to our Board of Directors. They're an outstanding group of folks that continue to give our management team very, very sound, and reasoned, and expert advice into all business segments

that we have. We built a great board that has disciplines in each of these to help us continue to evaluate those decisions and make good decisions for our investors and our invested capital.

As Kevin mentioned, we have our annual shareholder meeting. There's not anything exciting on the shareholder plans, but if you haven't voted your shares, please vote them. And we look forward to an update in sometime in April timeframe to give you a little bit more detail on the market. If you weren't able to ask a question or if you're listening this on the replay, don't hesitate, give me a holler and I'd be happy to give you any color or any information that would help you guide the decisions in ownership of the stock.

So with that, I will close and thank you all and look forward to speaking to you again soon.

Operator
Thank you, Mark. This concludes today's conference. You may now disconnect your line at this time. Thank you for your participation.