

PURE CYCLE CORP
Form 10-K
November 13, 2009

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K**

- ▶ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended August 31, 2009
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Commission File Number 0-8814
PURE CYCLE CORPORATION
(Exact name of registrant as specified in its charter)

Colorado

84-0705083

(State of incorporation)

(I.R.S. Employer Identification No.)

500 East 8th Ave, Ste 201, Denver, CO 80203

(303) 292-3456

(Address of principal executive office) (Zip Code)

(Registrant's telephone number, including area code)

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

Common Stock 1/3 of \$.01 par value

The NASDAQ Stock Market, LLC

(Title of each class)

(Name of each exchange on which registered)

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: \$40,337,000

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of November 12, 2009 was: 20,206,566

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III is incorporated by reference from the registrant's definitive proxy statement for the 2009 annual meeting of stockholders, which will be filed with the SEC within 120 days of the close of the fiscal year ended August 31, 2009.

Table of Contents

Item	Page
<u>Part I</u>	
<u>1. Business</u>	3
<u>1A. Risk Factors</u>	14
<u>1B. Unresolved Staff Comments</u>	19
<u>2. Properties</u>	19
<u>3. Legal Proceedings</u>	19
<u>4. Submission of Matters to a Vote of Security Holders</u>	19
<u>Part II</u>	
<u>5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	20
<u>6. Selected Financial Data</u>	22
<u>7. Management's Discussion and Analysis of Financial Condition and Results of Operation</u>	23
<u>7A. Quantitative and Qualitative Disclosures About Market Risk</u>	32
<u>8. Financial Statements and Supplementary Data</u>	32
<u>9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	62
<u>9A. Controls and Procedures</u>	62
<u>9B. Other Information</u>	63
<u>Part III</u>	
<u>10. Directors, Executive Officers and Corporate Governance</u>	63
<u>11. Executive Compensation</u>	63
<u>12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	63
<u>13. Certain Relationships and Related Transactions, and Director Independence</u>	63
<u>14. Principal Accounting Fees and Services</u>	63

Part IV

<u>15. Exhibits, Financial Statement Schedules</u>	63
<u>Signatures</u>	66
<u>Exhibit 23.1</u>	
<u>Exhibit 31.1</u>	
<u>Exhibit 32.1</u>	

Table of Contents

**SAFE HARBOR STATEMENT UNDER THE UNITED STATES PRIVATE
SECURITIES LITIGATION REFORM ACT OF 1995**

Statements that are not historical facts contained in this Annual Report on Form 10-K are forward looking statements that involve risk and uncertainties that could cause actual results to differ from projected results. The words anticipate, believe, estimate, expect, plan, intend and similar expressions, as they relate to us, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events and are subject to certain risks, uncertainties and assumptions. We cannot assure you that any of our expectations will be realized. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, without limitation, the timing of development of the areas where we may sell our water, including uncertainties related to the real estate market generally and the development of projects we currently have under contract, the market price of water, changes in customer consumption patterns, changes in applicable statutory and regulatory requirements, uncertainties in the estimation of water available under decrees, costs of delivery of water and treatment of wastewater, uncertainties in the estimation of costs of construction projects, the strength and financial resources of our competitors, our ability to find and retain skilled personnel, climatic and weather conditions, labor relations, availability and cost of material and equipment, delays in anticipated permit and construction dates, environmental risks, the results of financing efforts and the ability to meet capital requirements, and general economic conditions.

PART I

Item 1 Business

Summary of our business

Pure Cycle Corporation is a water and wastewater service provider engaged in the design, construction, operation and maintenance of water and wastewater systems. We have a vertically integrated business model which provides us with control and efficiency in the provision of water and wastewater services by owning all components necessary to offer complete water and wastewater services. Having a vertically integrated system means we own all assets required to provide water and wastewater services, including the following:

- Water rights used to provide domestic and irrigation water to customers;
- Infrastructure required to withdraw, treat, store and deliver domestic water to customers;
- Infrastructure required to collect, treat, store and reuse wastewater; and
- Infrastructure required to treat and deliver reclaimed water for irrigation use by customers.

We currently provide water services to approximately 247 single family equivalent water connections and 157 single family equivalent wastewater connections located in the southeastern Denver metropolitan area. We plan to utilize our significant water assets, which are summarized below, to provide residential/commercial water and wastewater services to other customers located along the eastern slope of Colorado generally known as the Front Range (the area east of the Rocky Mountains extending essentially from Ft. Collins on the north to Colorado Springs on the south). Principally we are targeting the I-70 corridor which is located east of downtown Denver and south of the Denver International Airport. This area is predominately undeveloped and is expected to experience substantial growth over the next 30 years. Our ability to increase our customer base is dependent on new development in our targeted service area and on our ability to enter into contracts to deliver water and wastewater service with land owners, land developers, home builders, and municipalities.

Our water rights are described in detail in the *Our Water Assets* section below, but in general we own over 12,000 acre-feet of decreed groundwater and surface water rights in the Denver area and have the exclusive right to use, through the year 2081, approximately 13,400 acre-feet of decreed groundwater and surface water located at the Lowry Range (defined in the *Our Water Assets The Lowry Range Property* section below). In addition to these Denver based assets, we also own approximately 60,000 acre-feet of Arkansas River water which is currently being used to irrigate approximately 17,500 acres of land we own in southeastern Colorado, and 70,000 acre-feet of conditionally decreed Colorado River water rights on the western slope of Colorado. Along the Front Range of Colorado, there are over 70 separate water providers with varying needs for replacement and new water supplies. We believe that we are well positioned to assist certain of these water providers in meeting their future water needs. Based on independent engineering estimates, our Denver portfolio can serve approximately 78,000 SFE's, while our Arkansas River supplies

(estimated to be approximately 40,000 acre feet per year of consumptive use water) can provide water service to an additional 100,000 SFE s for a combined capacity of approximately 180,000 SFE s.

Table of Contents

Glossary of terms

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

Acre-foot approximately 326,000 gallons of water, or enough water to cover an acre of ground with one foot of water. For some instances herein, as context dictates, acre feet is used to designate an annual decreed amount of groundwater or the amount of surface water that might be available during a typical year.

Consumptive Use the amount of water that is evaporated, transpired, incorporated into products or crops, consumed by humans or livestock, or otherwise removed from the immediate water environment.

Customer Facilities facilities that carry potable water and reclaimed water to customers from the Retail water distribution system and collect wastewater from customers and transfer it to the Retail wastewater collection system. Water and wastewater service lines, interior plumbing, meters and other components are typical examples of Customer Facilities. In many cases, portions of the Customer Facilities are constructed by the developer, but they are owned and maintained by the customer.

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

Section a parcel of land being one square mile and containing 640 acres.

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

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

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

Our Water Assets

This section should be read in conjunction with *Item 1A Risk Factors*, *Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operation*, *Critical Accounting Policies and Use of Estimates*, and Note 4 to the accompanying financial statements.

The \$103.2 million of capitalized water costs on our balance sheet represent the costs of the water rights we own and the related infrastructure developed to provide water and wastewater services. We own or have the exclusive rights to use water in several river basins throughout Colorado, with our most significant assets being located in the Denver metropolitan area and the Arkansas River basin in southern Colorado. Each of these assets is explained in detail below.

Table of Contents

Rangeview Water Supply and the Lowry Range

Our Rangeview Water

Our Rangeview Water Supply (defined below) includes a total of approximately 3,300 acre feet of tributary surface water, 25,050 acre feet of nontributary and not-nontributary groundwater rights, and storage rights associated with the Lowry Range.

Of the 25,050 acre feet of Lowry Range groundwater, we own approximately 11,650 acre feet of non-tributary and not-nontributary groundwater which we can export from the Lowry Range to supply water to nearby communities and developers in need of additional water supplies (this water asset is referred to as our Export Water). We also have the right to convert up to 1,650 acre feet of the Export groundwater to a similar amount of surface water for use off the Lowry Range. We hold the exclusive right to develop and deliver (through 2081) the remaining 13,400 acre feet of groundwater, along with the balance of the surface water, for use on the Lowry Range. Collectively we refer to these as our Rangeview Water Supply.

We acquired our Rangeview Water Supply in April 1996 pursuant to the following agreements, which collectively are referred to as the Rangeview Water Agreements :

- (i) The 1996 Amended and Restated Lease Agreement (the Lease) between the State Board of Land Commissioners (the Land Board) and the Rangeview Metropolitan District (the District), a quasi-municipal political subdivision of the State of Colorado,
- (ii) The Agreement for Sale of Export Water between us and the District, and
- (iii) The Service Agreement between us and the District for the provision of water service to the Lowry Range.

Pursuant to the Rangeview Water Agreements, we design, construct, operate and maintain the District's water and wastewater systems to provide water and wastewater service to customers within the District's 24,000 acre service area at the Lowry Range. In exchange for providing water service, we receive 95% of all amounts received by the District relating to water services, after deducting the required royalty to the Land Board, which initially totals 12% of gross revenues received from water sales. The Rangeview Water Agreements require us to charge customers fair market rates for water service based on the average of similar rates and charges at three nearby communities. See the *Water and Wastewater Tap Fees* section below.

Pursuant to the Wastewater Service Agreement (the Wastewater Agreement) between us and the District, we also design, finance, construct, operate and maintain the District's wastewater system to provide wastewater service to customers within the District's service area. In exchange for providing wastewater services, we receive 100% of the District's wastewater tap fees and 90% of the District's monthly wastewater service fees, as well as the right to use or sell the reclaimed water.

On the Lowry Range, we operate both the water and the wastewater systems during our contract period on behalf of the District, who owns the facilities for both systems. At the expiration of our contract term in 2081, ownership of the water system facilities servicing customers on the Lowry Range will revert to the Land Board, with the District retaining ownership of the wastewater facilities.

Off the Lowry Range, we use our Export Water as well as other supplies owned by us to provide water service to our customers and we own these facilities.

Historically we have contracted with third parties for the construction of these facilities, which is a practice we plan to continue.

The Lowry Range Property

The Lowry Range was acquired by the Land Board in the 1960's and according to the Land Board it is one of the most complex and visible properties held in trust by the Land Board. Located in unincorporated Arapahoe County, about 20 miles southeast of Metro Denver, the Lowry Range is one of the largest contiguous parcels under single ownership next to a major metropolitan area in the United States. The Lowry Range is Approximately 26,000 acres in size or about 40 square miles of land. Of the 26,000 acres, we have the exclusive rights to provide water and wastewater services to approximately 24,000 acres.

Table of Contents

In December 2006, the Land Board selected two development partners for the Lowry Range, one for a parcel designated by the Land Board as the Development Parcel (including approximately 3,800 acres of the Lowry Range) and one for a parcel designated as the Conservation Parcel (including approximately 17,000 acres). In June 2007, the Land Board entered into an agreement with a developer for sole development rights of six sections of the Lowry Range. Of this, we have the exclusive rights to provide water and wastewater services to two sections (or approximately 1,300 acres). As further detailed in *Item 1A Risk Factors*, in January 2009, the developer withdrew from the project. We continue to work with the Land Board to develop the Lowry Range water assets for customers located on and off the Lowry Range using the Lowry Range's surface and groundwater supplies in conjunction with a water management program to provide state-of-the-art, environmentally sensitive, sustainable water and wastewater services, at commercially reasonable rates. The Land Board to date has not finalized an agreement on the Conservation Parcel with its tentative partner.

Despite the developer's withdrawal, our agreements with the District and the Land Board remain intact and we remain the exclusive water service provider to 24,000 acres of the Lowry Range. The Land Board continues to own the property and has stated its desire to continue to pursue its three-part vision for the Lowry Range which includes land development, conservation, and water resource development. However, we are not aware of any other projects planned by the Land Board and it may be some time before the Land Board commences another project. Beginning in the 1980's and continuing with the Lease, we have been a dedicated partner with the Land Board in the pursuit of development opportunities at the Lowry Range. We continue to invest in and expand our capabilities to provide water and wastewater services to the Lowry Range and we look forward to continuing to work with the Land Board on these important and valuable assets.

Additionally, on June 1, 2009, the Colorado Supreme Court upheld the decision of the District Court, Water Division I, State of Colorado (*Water Court*) requiring the City of Aurora (*Aurora*) to remove three reservoir sites from its *Water Court* applications because the reservoir sites were already adjudicated to us pursuant to agreements with the Land Board. This process began in 2003 when Aurora filed an application for conditional water rights with the *Water Court* in which Aurora listed numerous potential sites for reservoirs for storage of its water rights. Three of the potential reservoir sites were located on the Lowry Range on reservoir sites which had been adjudicated by the District and the Land Board and for which the Land Board had previously granted the right to obtain rights-of-way and to construct reservoirs to the District.

Water supplies and water storage reservoirs are competitively sought throughout the west and along the Front Range of Colorado. We believe regional cooperation among area water providers in developing new water supplies and water storage provides the most cost effective way of expanding and enhancing service capacities for area water providers. We continue to discuss developing water supplies and water storage opportunities with area water providers.

Arkansas River Water

We own approximately 60,000 acre-feet of senior water rights in the Arkansas River basin. Currently this water is being used for agricultural purposes on the approximately 17,500 acres of real property we own in Southern Colorado, which is being leased to area farmers. The water rights we own are represented by over 21,600 shares of the Fort Lyon Canal Company (the *FLCC*), which is a non-profit mutual ditch company established in the late 1800's to operate and maintain the 110-mile long Fort Lyon Canal between La Junta, Colorado and Lamar, Colorado. We acquired these assets on August 31, 2006, from High Plains A&M, LLC (*HP A&M*) pursuant to an asset purchase agreement (the *Arkansas River Agreement*). Pursuant to agreements we entered into with *HP A&M*, described in greater detail in Note 4 to the accompanying financial statements, the management of these farm leases is being performed by *HP A&M* through August 31, 2011. After that date, depending on certain factors described in the accompanying financial statements, *HP A&M* may extend the management services agreement, or we may assume management of the farms. Pursuant to the management services agreement, while *HP A&M* is managing the leases, *HP A&M* is responsible for all expenses associated with maintaining the leases with the exception of the water assessment fees paid to the *FLCC*, which fees are borne by us. As compensation for their management responsibilities, *HP A&M* retains all lease and certain other non-crop income associated with the farms and the water used thereon.

The farm land and related personal property and other non-water assets were acquired because the amount of water we will ultimately be permitted to develop for municipal purposes is based on the historical consumptive use of such

water. We anticipate that approximately 40,000 acre-feet of the 60,000 acre-feet we own will be available for non-agricultural uses along the Front Range, but the Arkansas River Water will not be available for such purposes until we successfully file for a change of use in Water Court as described below. By owning the land and having the water continue to be used for agricultural purposes, we continue to maintain beneficial use of the water.

Table of Contents

In order to use this water for municipal purposes we must file a change of use application with the Water Court. This will likely be a lengthy process and require a substantial amount of capital for legal and engineering services. If we successfully change the use of our water rights to include municipal uses, we would then need to construct a pipeline and other infrastructure to transport the water to the municipal customers, which could cost in excess of \$500 million. Although we have not yet filed a change of use application. We are working with the FLCC and other interested parties in the Arkansas River Valley to mitigate any adverse impacts to the local communities and to make investments and decisions on farming operations which benefit continued agricultural operations as well as providing new municipal water supplies for the Front Range. We are conducting a rotational crop study program and participating in discussions with area interests including the Lower Arkansas Valley Super Ditch (Super Ditch), which is a group of Arkansas Valley irrigators that have assembled to study alternatives to traditional buy and dry agricultural-to-municipal water transfers.

Due to the renewable nature of surface water, owning this large portfolio of surface water allows us to more effectively market our water and wastewater services to customers in the Denver metropolitan market as well as other markets such as the Colorado Springs region. Timing of the development of the Arkansas River water will depend on the timing of new connections to our water and wastewater systems. We plan to fund the development of the Arkansas River water, much like the other water we own, by using proceeds generated from the sale of taps associated with new connections to our system. In addition to increasing our service capacities, the Arkansas River water may present additional market opportunities for us to assist other water providers in solving their long-term water supply needs for their existing and new connections. See also *Item 1A Risk Factors* for additional information on the risks associated with a water transfer case and other risks associated with the Arkansas River water.

Arapahoe County Fairgrounds Agreement for Water Service

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

Pursuant to the County Agreement we constructed various Wholesale and Special Facilities, including a new deep water well, a 175 foot tall, 500,000 gallon water tank and pipelines to transport water to the Fairgrounds. The construction of the Special and Wholesale facilities were completed in our fiscal 2006, and we began providing water service to the Fairgrounds on July 21, 2006.

Sky Ranch Water Supply and Water Service Agreements

The Sky Ranch property incorporates approximately 950 acres located four miles north of the Lowry Range along Interstate 70. As described in *Item 1A Risk Factors* below, the developer of Sky Ranch currently has a plan of liquidation pending in federal bankruptcy court. We are party to two Water Service Agreements (the Sky Ranch Agreements) with the developer of Sky Ranch which, based on the approved preliminary development plans, obligate us to provide water service to the homes, businesses, schools and other customers at the development, which could include service to up to 4,850 SFEs. The Sky Ranch Agreements also grant us the right to purchase a total of 760 acre feet of water located beneath Sky Ranch as described in greater detail in Note 4 to the accompanying financial statements. Due to the pending bankruptcy proceeding, the timing of development at Sky Ranch, if any, and the status of the Sky Ranch Agreements, is uncertain.

Paradise Water Supply

In 1987 we acquired the conditional rights to build a 70,000 acre-foot reservoir to store Colorado River tributary water and a right-of-way permit from the U.S. Bureau of Land Management for property at the dam and reservoir site (collectively known as our Paradise Water Supply). Due to the significant development costs of water assets along the western slope and agreements with other western slope water interests, the use of our Paradise Water Supply is limited to opportunities along the western slope. See discussion of impairment analysis in the *Critical Accounting Policies* section below for more information. See also Note 4 to the accompanying financial statements for information concerning the Finding of Reasonable Diligence review by the State Engineer.

Table of Contents**Well Enhancement and Recovery Systems**

In January 2007, we, along with two other parties (each of whom own 1/3rd of the venture), formed Well Enhancement and Recovery Systems, LLC (Well Enhancement LLC), to develop a new deep water well enhancement tool and process which we believe will increase the efficiency of wells into the Denver Basin groundwater formation. In our fiscal 2008, the well enhancement tool and process was completed and tested on two deep water wells developed by an area water provider with favorable results. According to studies performed by an independent hydro-geologist, preliminary results indicate the well enhancement tool effectively increased the production of the two test wells by approximately 80% and 83% when compared to that of nearby wells developed in similar formations at similar depths. Based on the positive results of the test wells, we continue to refine the process of enhancing deep water wells and anticipate marketing the tool to area water providers. We did not utilize the well enhancement tool during 2009 due to a lack of wells being drilled in the Denver metropolitan market. During the fiscal years ended August 31, 2009, 2008 and 2007, Well Enhancement LLC expensed approximately \$17,100, \$143,600 and \$106,700, respectively, for research and development activities. Since we are a 1/3rd owner of Well Enhancement LLC, we recorded approximately \$7,900, \$48,700 and \$35,600, respectively, of Well Enhancement LLC's losses for the fiscal years ended August 31, 2009, 2009 and 2007.

Revenues

We generate revenues predominately from three sources:

1. Water and wastewater tap fees,
2. Construction fees, and
3. Monthly service fees.

We typically negotiate the payment terms for tap fees, construction fees, and other water and wastewater service fees with each developer, builder or municipality before we commit to providing service and before construction of the project commences.

Water and Wastewater Tap Fees

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

Pursuant to our Rangeview Water Agreements with the District and the Land Board, pricing for water tap fees (as well as water usage charges described further below) is controlled through a market-driven pricing mechanism in which our rates and charges may not exceed the average of similar rates and charges of three nearby water providers. Due to increases in tap fees at these communities, effective July 1, 2009, water tap fees increased \$1,000 to \$22,500 per SFE, which is a 4.7% increase over the 2008 water tap fee. Wastewater tap fees remained unchanged at \$4,883. Table A provides a summary of our water tap fees since 2003:

Table A Water System Tap Fees

	2009	2008	2007	2006	2005	2004	2003
Water tap fees per SFE	\$ 22,500	\$ 21,500	\$ 20,000	\$ 16,840	\$ 14,740	\$ 12,420	\$ 11,150
Percentage Increase	4.7%	7.5%	18.8%	14.2%	18.7%	11.4%	6.2%

Tap fees revenues are deferred and recognized in the statement of operations as income as described in *Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operation - Critical Accounting Policies and Use of Estimates* and Note 2 to the accompanying financial statements.

Developers owning rights to either surface water or groundwater underlying their properties may receive a credit against a portion of their water tap fees if they elect to sell their water to us, which is negotiated at the time of the service agreement.

Table of Contents**Construction Fees**

Construction fees are fees we receive, typically in advance, from developers, for us to build certain infrastructure such as Special Facilities. Construction revenues are deferred and recognized in the statement of operations as income as described in *Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operation Critical Accounting Policies and Use of Estimates* and Note 2 to the accompanying financial statements.

Monthly Service Fees

Monthly water usage charges are assessed to our customers based on actual metered usage each month. Water usage pricing uses a tiered pricing structure which is capped at the average of the prices charged by the same three surrounding water providers used as the basis for our water tap fees. Despite increases by these water providers, in 2009 we chose not to increase our monthly usage rates in order to provide more competitive usage charges in our service area; however, the tiered pricing structure has increased over the past several years as noted in Table B below:

Table B Tiered Water Usage Pricing Structure

Amount of consumption	Price (\$ per thousand gallons)					
	2009	2008	2007	2006	2005	2004
Base charge per SFE	\$ 25.11	\$ 25.11	\$ 25.11	\$ 20.44	\$ 20.28	\$ 19.80
0 gallons to 10,000 gallons	\$ 2.55	\$ 2.55	\$ 2.55	\$ 2.58	\$ 2.46	\$ 2.40
10,001 gallons to 20,000 gallons	\$ 3.35	\$ 3.35	\$ 3.35	\$ 3.34	\$ 3.17	\$ 3.10
20,001 gallons and above	\$ 5.96	\$ 5.96	\$ 5.96	\$ 5.90	\$ 5.54	\$ 5.40

Water revenues are sensitive to timing and volume of water use, meaning the more water used by a customer in a given month, the higher the cost of additional incremental water deliveries to the customer. Based on this, for a typical residential customer using approximately 0.4 acre-feet of water annually, during a typical weather year, water usage fees total approximately \$673 per year.

Wastewater customers are charged a flat monthly fee of \$39.50 per SFE, or \$474 per year per SFE, which was last increased on July 1, 2007 from \$34.80 per SFE, an increase of 13.5%.

We also collect other immaterial fees and charges from residential customers and other end users to cover miscellaneous administrative and service expenses, such as application fees, review fees and permit fees.

Land Board Royalties and District Fees

Pursuant to the Rangeview Water Agreements, the Land Board is entitled to royalty payments based on a percentage of revenues earned from water sales that utilize water from the Lowry Range or Export Water. The calculation of royalties depends on whether the customer is located on the Lowry Range or elsewhere, and whether the customer is a public or private entity. In addition, the District is entitled to retain 5% of amounts collected with respect to water sales to customers located on the Lowry Range, after deducting the royalty payment to the Land Board.

Pursuant to the Wastewater Agreement, the District is entitled to 10% of our wastewater service charge revenue (not including wastewater tap fees) from customers on the Lowry Range. The Land Board does not receive a royalty from wastewater services.

Lowry Range Customers

For services to customers located on the Lowry Range, the District collects fees from customers, pays the royalties to the Land Board, retains its own fee, and remits the remainder to us. Water service related payments from customers on the Lowry Range generate royalties to the Land Board at a rate of 12% of gross revenues. When either (i) metered production of water used on the Lowry Range in any calendar year exceeds 13,000 acre-feet or (ii) 10,000 surface acres on the Lowry Range have been rezoned to non-agricultural use, finally platted and water tap agreements have been entered into with respect to all improvements to be constructed on such acreage, the Land Board may elect, at its option, to receive, in lieu of its royalty of 12% of gross revenues, 50% of the net profits derived by the District and Pure Cycle after the Land Board's election from the sale or other disposition of water on the Lowry Range. To date neither of these conditions has been met and such conditions are not likely to be met any time soon.

Table of Contents

Export Water Customers

Payments for Export Water also generate royalty payments to the Land Board. These royalties vary depending on a number of factors. When we withdraw, treat and deliver water to customers located off the Lowry Range, incurring the costs related to this process, royalties to the Land Board are based on our Net Revenues, (which are defined as: gross revenues less costs, including reasonable overhead allocations, incurred as a direct and indirect result of incremental activity associated with the withdrawal, treatment and delivery of the water). Royalties payable to the Land Board for Export Water sales escalate based on the amount of Net Revenue we receive and are lower for sales to a water district or similar municipal or public entity than for sales to a private entity as noted in Table C:

Table C Royalties for Export Water Sales

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

Our Current Operations

We designed, built and operate water and wastewater systems that serve customers both on the Lowry Range as well as customers off the Lowry Range including the Arapahoe County Fairgrounds.

During fiscal 2009 we delivered approximately 33.9 million gallons of potable water to our customers. On average, this equates to approximately 830,000 gallons per month during the winter and over six (6) million gallons per month during the summer. Our wastewater treatment facility has a permitted capacity of 130,000 gallons per day and currently receives about 40,000 gallons per day.

We operate and maintain all of our water and wastewater facilities with limited assistance from third party contractors. We designed, constructed and operate the facilities serving customers on the Lowry Range and plan to operate this system, together with facilities serving customers in areas outside the Lowry Range, in an integrated manner to capitalize on economies of scale and ensure the most efficient use of our water. Currently we provide service to approximately 247 single family equivalent water connections and 157 single family wastewater connections both on and off the Lowry Range.

Significant Customers

Table D lists the customers which accounted for 10% of more of our revenues for the fiscal years ended August 31, 2009, 2008 and 2007, respectively.

Table D Significant Customers

	% of Water Usage Fees		
	2009	2008	2007
Ridgeview Youth Services Center	72%	71%	67%
Schmidt Aggregates	13%	15%	20%
Combined	85%	86%	87%

	% of Wastewater Service Fees		
	2009	2008	2007
Ridgeview Youth Services Center	100%	100%	100%

Table of Contents

Our Projected Operations

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

We design, construct and operate our existing and future water and wastewater facilities using advanced water purification and wastewater treatment technologies which allow us to use our water supplies in an efficient and environmentally friendly manner. We plan to develop our water and wastewater systems in stages to efficiently meet increasing demands in our service areas, thereby reducing the amount of up-front capital costs required for construction. We use third party contractors to construct our facilities as needed. We employ licensed water and wastewater operators to operate our water and wastewater systems. As our systems expand, we expect to hire additional personnel to operate our systems, read meters, bill customers, and manage our operations. We plan to take advantage of advanced technologies, such as systems that enable meter readings and billings to be done remotely, to keep labor and other operating costs low.

Our water and wastewater systems conjunctively use surface and groundwater supplies and storage of raw water and highly treated effluent supplies to provide a balanced sustainable water supply for our customers. Integrating conservation efforts with effective water reuse makes our water and wastewater systems environmentally responsible.

Our Denver based supplies are a valuable, locally available, resource located near the point of use. This enables us to incrementally develop infrastructure to produce, treat and deliver water to customers based on their growing demands. Adding our locally available supplies to our intermediate and longer term supplies from the Arkansas River balances both current and ongoing supplies to meet the growing water demands in the Front Range market.

Our Arkansas River supplies are located in southeast Colorado and will require an approximately 130-mile pipeline and water treatment and pumping facilities with an estimated cost of over \$500 million to deliver the water to Front Range customers. We are currently investigating various pipeline alignments and potential partnerships for construction of these facilities. We are also in discussion with the Arkansas Valley Super Ditch which is studying the feasibility of developing a system-wide mechanism to transfer water from the Arkansas River basin to water short regions through a rotational crop fallowing program. Converting the Arkansas Water to municipal use and constructing a delivery system will be a long-term process, but one which will allow us to work closely with those who might benefit or otherwise be impacted by any water transfers. The development of this water will require us to apply for a change of use application in the Water Court which is anticipated to take from one to more than three years and require a significant capital investment. However, we do not plan on starting this process in the near term and anticipate that the tap fees and usage fees from taps sold utilizing our Rangeview Water Supply, along with funding from other pipeline partners, will be sufficient to fund the water delivery facilities.

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

Rangeview Metropolitan District

The District is a quasi-municipal corporation and political subdivision of Colorado formed in 1986 for the purpose of providing water and wastewater service to the Lowry Range. The District is required to utilize the 13,400 acre-feet of water leased to it by the Land Board to serve customers on the Lowry Range.

The District is run by an elected board of directors. The only eligible voters and the only persons eligible to serve as directors are the owners of property within the boundaries of the District. We own certain rights to the real property which encompasses the current boundaries of the District. The current directors of the District are Mark W. Harding and Scott E. Lehman (both employees of Pure Cycle), and an independent board member.

Table of Contents

We are party to a Right of First Refusal Agreement with the owners of the property comprising the District. Pursuant to a tenancy in common agreement, in the event of death, bankruptcy or incompetence of any tenant, that tenant's estate or representative must offer the property interest of that tenant to the remaining tenants for purchase. If the remaining tenants do not purchase all of such person's interest, the property must be offered to us pursuant to the Right of First Refusal Agreement. In addition, if any tenant wants to sell his interest in the parcel, such tenant must find a bona fide buyer and then offer the property to us. We have the right, at our option, to buy the property by matching the terms of the bona fide third party offer or by paying the appraised value of the property as determined by independent appraisers. A tenant may also negotiate a sale directly with us if he elects not to locate a bona fide buyer. Each of the directors listed above currently owns an undivided interest in the land comprising the District. Under applicable Colorado law, entities are not qualified to serve as directors of municipal districts and may not vote. Our President and Corporate Secretary serve as elected members of the board of directors of the District. Pursuant to Colorado law, directors receive \$100 for each board meeting or a maximum of \$1,600 per year.

We and the District's board of directors transact business on an arms-length basis. Potential conflicts of interest of the directors in transactions between us and the District are disclosed in filings with the Colorado Secretary of State. The District and we were each represented by separate legal counsel in negotiating the Rangeview Water Agreements and those agreements were approved by the independent members of the District's board and by the Land Board at the time they were entered into.

It is likely that at some point in the future, the District's board of directors will be comprised entirely of independent directors. As the Land Board develops the Lowry Range, landowners on the Lowry Range may petition to include their land within the District's boundaries. Provided such petition complies with applicable law, the District is required by the Rangeview Water Service Agreements to proceed with due diligence to include the area designated in such petition within the District's boundaries. As the District's boundaries expand, the base of persons eligible to serve as directors and eligible to vote will also increase.

Water and Growth in Colorado

In 2009, the Colorado economy, much like that of the US as a whole, has experienced a continuing recession. Housing starts fell nearly 60% over the prior year and the unemployment rates rose to 7.3% in August 2009, as compared to 4.9% in August 2008. Despite this, the Denver Regional Council of Governments (DRCOG), a voluntary association of over 50 county and municipal governments in the Denver metropolitan area, estimates that the Denver metropolitan area population will increase by about 44% from today's 2.7 million people to 3.9 million people by the year 2030. A recent Statewide Water Supply Initiative report by the Colorado Water Conservation Board estimates that the South Platte River basin, which includes the Denver metropolitan region, will grow from a current population of approximately 3.2 million to approximately 4.9 million by the year 2030; while the state populations increases from 4.7 million to 7.2 million. Accordingly, approximately 70% of the projected state population increase is anticipated to occur within the South Platte River basin. Significant increases in Colorado's population, particularly in the Denver metro region and other areas in the water short South Platte River basin, together with increasing agricultural, recreational, and environmental water demands will intensify competition for water supplies. Estimated population increases brings increased demand for water services; exceeding what municipal service providers are currently capable of providing especially during drought conditions. The Statewide Water Supply Initiative estimates that population growth in the Denver region and the South Platte River Basin will result in additional water supply needs of over 400,000 acre feet by the year 2030, which must be met with new water sources. Many cities and municipalities require property developers to demonstrate they have sufficient water supplies for their proposed projects before considering rezoning or annexation applications. Based on this, we focus our water marketing activities to developers and homebuilders that are active along the Colorado Front Range as well as other area water providers in need of additional supplies.

Colorado's future water supply needs will be met through conservation, reuse and the development of new supplies. Our rules and regulations for water and wastewater service call for adherence to strict conservation measures, including low flow water fixtures, high efficiency appliances, and advanced irrigation control devices. Additionally, our systems are designed and constructed using a dual-pipe water distribution system that has one pipe to supply customers with high quality potable drinking water and a second pipe to supply raw or reclaimed water for irrigation.

Typically, about one-half of the water needed to meet Denver-area residential water demands is used for lawn and outdoor landscape irrigation. Along with most major water providers, we believe that raw or reclaimed water supplies provide the lowest cost water for irrigation. Our systems will include an extensive water reclamation system, in which essentially all effluent water from wastewater treatment plants will be reused to meet non-potable water demands. This will enhance our ability to provide quality water service and reinforce the importance of water reuse and our commitment to environmentally responsible water management policies.

Table of Contents

Competition

We negotiate individual service agreements with developers and/or homebuilders, cities and municipalities to design, construct and operate water and wastewater systems and to provide services. These service agreements address all aspects of the development of the water and wastewater systems including:

- (i) The purchase of water and wastewater taps in exchange for our obligation to construct the Wholesale Facilities,
- (ii) The establishment of payment terms, timing, capacity and location of Special Facilities (if any), and
- (iii) Specific terms related to our provision of ongoing water and wastewater services.

Although we have exclusive long-term water and wastewater service contracts for the majority of the Lowry Range (we currently have the exclusive rights to serve two of the six development sections currently proposed at the Lowry Range), providing water service using our Export Water and Arkansas River water is subject to competition. Moreover, competitors have attempted to challenge our exclusive rights to service the Lowry Range. See *Item 1A Risk Factors – Lowry Range* below. Alternate sources of water are available, principally from other private parties, such as farmers or others owning senior water rights that have historically been used for agriculture, and from municipalities seeking to annex new development areas in order to increase their tax base. Our principal competition in areas close to the Lowry Range is the City of Aurora, which has the ability to offer potential purchasers incentives, such as annexation and tax credits, which we cannot. The other principal factors affecting competition for potential purchasers of our Arkansas River water and Export Water include the availability of water for the particular purpose, the cost of delivering the water to the desired location and the reliability of the water supply during drought periods. We believe the water assets we own and have the exclusive right to use, which have a supply capacity of approximately 180,000 SFE units, provide us a significant competitive advantage along the Front Range. Our legal rights to the Rangeview Water Supply have been confirmed for municipal use and a significant portion of our water supply is close to Denver area water users. Our pricing structure is competitive and our water portfolio is well balanced with senior surface water rights, groundwater rights, storage capacity and reclaimed water supplies.

Employees

We currently have three full-time employees and one part-time employee.

Available Information and Website Address

Our website address is www.purecyclewater.com. We make available free of charge through our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to these reports as soon as reasonably practicable after filing with the SEC. They also may be obtained directly from the SEC's website, www.sec.gov/edgar/searchedgar/companysearch.html, under CIK code **276720**. The contents of our website are not incorporated by reference into this report.

Item 1A – Risk Factors

Our business, operations, and financial condition are subject to significant risks. These risks include those listed below and may include additional risks of which we are not currently aware or which we currently do not believe are material. If any of the events or circumstances described in the following risk factors actually occurs, our business could be materially adversely affected. These risks should be read in conjunction with the other information set forth in this report.

We are dependent on the development of the Lowry Range, Sky Ranch, and other areas near our Rangeview Water Supply that are potential markets for our Rangeview Water Supply.

Providing water service using our Rangeview Water Supply is one of our principal sources of future revenue. The timing and amount of these revenues will depend significantly on the development of the Lowry Range, Sky Ranch and other potential developments near our Rangeview Water Supply and along the Colorado Front Range. The development of these areas is not within our control.

Table of Contents

Lowry Range

As noted in *Item 1 Business*, in June 2007, the Land Board entered into an agreement with a developer for the sole development rights of six sections (or approximately 3,900 acres) of the Lowry Range. Of this, approximately two sections (or approximately 1,300 acres) were subject to our service rights under the Lease. In January 2009, the developer withdrew from the development agreement. The Land Board continues to own the property, however; we are not aware of any other projects planned by the Land Board and it may be some time before the Land Board commences another project. Even if the Land Board does proceed with another development plan, there can be no assurance that development will occur or that water sales will occur on acceptable terms or in the amounts or time required for us to support our costs of operation.

Additionally, certain of our rights on the Lowry Range have been challenged. On June 1, 2009, the Colorado Supreme Court upheld the decision of the Water Court requiring the City of Aurora to remove certain reservoir sites from its Water Court applications because the reservoir sites were already adjudicated to us pursuant to agreements with the Land Board. While Aurora has been unsuccessful so far in obtaining rights to the adjudicated reservoirs under the Lease, additional legal action may become necessary to enforce our rights to the reservoirs and to provide water and wastewater service to the Lowry Range. If additional legal proceedings become necessary and our rights under the Lease are adversely ruled upon in such legal proceedings, it could materially adversely impact the value of our interests, including the value of our Rangeview Water Supply.

Our surface water interests and reservoirs sites at the Lowry Range are conditional decrees and are subject to a Finding of Reasonable Diligence from the Water Court every six years. To arrive at that finding, the Water Court must determine that we, together with the Land Board, continue to diligently pursue the development of the water rights. If the Water Court is unable to make such a finding, these portions of the Lowry Range water supply could be lost. The Lowry Range conditional decrees are currently under their first review by the Water Court to determine if such decrees meet the diligence criteria. If the Water Court does not make a determination of reasonable diligence, it would materially adversely impact the value of our interests in the Rangeview Water Supply.

Because of the prior use of the Lowry Range as a military facility, environmental clean-up may be required prior to development, including the removal of unexploded ordnance. There is often significant delay in adoption of development plans, as the political process involves many constituencies with differing interests. In the event water sales are not forthcoming or development of the Lowry Range is delayed indefinitely, we would need to incur additional short or long-term debt obligations or seek to sell additional equity to generate operating capital, and there are no assurances that we would be successful in obtaining additional operating capital. In addition, the Land Board may not develop large portions of the Lowry Range significantly limiting our ability to utilize the non-Export Water specifically reserved for use on the Lowry Range.

Sky Ranch

The developer of Sky Ranch has filed a plan of liquidation in bankruptcy court, which remains pending. There has been no resolution of our claims against the developer of Sky Ranch and we do not know how the liquidation will impact our agreements with Sky Ranch or the Sky Ranch property. The Sky Ranch Agreements could be rejected in the bankruptcy proceeding leaving us with unsecured damage claims which would likely have little or no value. In addition to our claims against the developer, a bank holds a security interest in the entire Sky Ranch development, including our agreements. We are not aware of the bank's intentions with respect to its rights in the development. Until these issues are resolved, there will be no development and consequently no sales of water taps or water at Sky Ranch. We cannot reasonably predict how long this process will take or whether any of our rights related to Sky Ranch will have any value following the liquidation of the Sky Ranch developer.

The Colorado housing market and economic conditions could adversely affect our operations.

Our operations are affected by general economic conditions and the pace and location of real estate development activities in the greater Denver metropolitan area, most particularly areas which are close to our Rangeview Water Supply. Since 2006, the Colorado housing market has seen significant declines in new construction, which could continue for some time. The current instability in the credit markets has exacerbated the decline in demand for new homes. New connections to our water and wastewater systems depend on real estate development in our service areas. We have no ability to control the pace and location of real estate development activities which affect our business. If

the downturn in the homebuilding and credit markets continues, intensifies, or if the national economy weakens further and economic concerns intensify, it could have a significant negative impact on our business.

Table of Contents

We are involved in on-going discussion with the Land Board to clarify our rights and obligations with respect to our Rangeview Water Supply and such negotiations may not be successful.

Our Rangeview Water Supply rights derive principally from the Lease between the Land Board and the District which was entered into in 1996 prior to any development of the Lowry Range or of areas outside the Lowry Range that utilize our Export Water. The terms of the Lease did not fully anticipate the specific circumstances of development that have arisen and may not clearly delineate rights and responsibilities for the forms of transactions that may arise in the future. We are involved in ongoing discussions with the Land Board to clarify the terms of the Lease. An unfavorable outcome in such discussion could have a material adverse effect on our financial results.

In order to utilize the Arkansas River water acquired in fiscal 2006, we must apply for a change of use with the Water Court and this may take several years to complete.

The change of use of our Arkansas River water requires a favorable ruling by the Water Court, which could take several years and be a costly and contentious effort since it is anticipated that many parties will oppose the change of use and the transfer of the water. There are several conditions which must be satisfied prior to our receiving a change of use decree for transfer of our Arkansas River water. One condition that we must satisfy is a showing of anti-speculation in which we, as the applicant, must demonstrate that we have contractual obligations to provide water service to customers prior to the Water Court ruling on the transfer of a water right. The Water Court is also expected to limit the transfer to the consumptive use portion of the water right and to address changing the historic use of the water from agricultural uses to other uses such as municipal and industrial use. We expect to face opposition to any consumptive use calculations of the historic agricultural uses of this water. The Water Court may impose conditions on our transfer of the water rights such as requiring us to mitigate the loss of the farming tax base, imposing re-vegetation requirements to convert soils from irrigated to non-irrigated, and imposing water quality measures. Any such conditions will likely increase the cost of transferring the water rights.

We may not be able to obtain sufficient capital to develop our water rights, in particular the Arkansas River water.

Development of water rights requires a substantial capital investment. We anticipate financing water and wastewater systems primarily through the sale of water taps and water delivery charges to users. However, we cannot assure you that these sources of cash will be sufficient to cover our capital costs. Moreover, the development of the Arkansas River water will require a pipeline and other infrastructure to deliver the water to the Front Range, which is anticipated to cost over \$500 million. We likely would be required to partner with others to finance a project of this magnitude and there is no assurance we would be able to obtain the financing necessary to develop our Arkansas River water.

Our valuation of the Tap Participation Fee payable to HP A&M contains estimates and management assumptions. The actual results could differ significantly from those estimates.

As part of our acquisition of the Arkansas River water rights from HP A&M, we granted HP A&M a tap participation fee entitling HP A&M to receive ten percent (10%) of the gross proceeds of our sales of forty thousand (40,000) water taps (the Tap Participation Fee). For accounting purposes we have estimated the fair value of the Tap Participation Fee payable to HP A&M using available historic market information and estimated future market data and projections. We believe the estimates we used reasonably reflect the fair value of the Tap Participation Fee. Accounting estimates involve matters of uncertainty and judgment and interpreting relevant market data is inherently subjective in nature. Many factors are necessary to estimate future market conditions, including but not limited to, supply and demand for new homes, population growth along the Front Range, tap fee increases at our rate-base districts, and other market forces beyond our control. The actual results could differ materially from the accounting estimates reflected in our balance sheet which would result in significant changes to the fees being paid to HP A&M and to the imputed interest being reflected on our future statements of operations associated with the Tap Participation Fee.

In the event of default by HP A&M on any of the promissory notes secured by deeds of trust on our properties, we would be required to cure the defaults or lose the properties.

Certain of the real properties we acquired from HP A&M are subject to promissory notes, aggregating approximately \$12.0 million in principal and interest as of August 31, 2009. The notes are secured by deeds of trust on the properties we own, but are solely the responsibility of HP A&M. Because of HP A&M's financial position and the substantial penalties imposed on HP A&M in the event of a default, the likelihood of HP A&M defaulting on the notes is deemed

remote. As a result the promissory notes are not reflected on our balance sheet. However, if HP A&M was to default on any of the notes, and the defaults were not cured, we would lose up to approximately 60 of the 80 real properties we acquired which equates to approximately 75% of our Arkansas River water rights.

Table of Contents

Our net losses may continue and we may not have sufficient liquidity to pursue our business objectives.

We have experienced significant net losses and could continue to incur net losses. For the fiscal years ended August 31, 2009, 2008 and 2007, we had net losses of approximately \$5.7 million, \$6.9 million and \$6.9 million, respectively, on revenues of approximately \$260,200, \$282,400 and \$265,700, in the respective periods. Our cash flows from operations have not been sufficient to fund our operations in the past, and we have been required to raise debt and equity capital to remain in operation. Since 2004, we have raised approximately \$21.5 million through the issuance of common stock to support our operations. Our ability to fund our operational needs and meet our business objectives will depend on our ability to generate cash from future operations. If our future cash flows from operations and other capital resources are not sufficient to fund our operations and the significant capital expenditure requirements to build our water delivery systems, we may be forced to reduce or delay our business activities, or seek to obtain additional debt or equity capital, which may not be available on acceptable terms, or at all.

The rates we are allowed to charge customers on the Lowry Range are limited by the Lease with the Land Board and our contract with the District and may not be sufficient to cover our costs of construction and operation.

The prices we can charge for our water and wastewater services on the Lowry Range are subject to pricing regulations set in the Lease with the Land Board. Both the tap fees and our usage rates and charges are capped at the average of the rates of three surrounding water providers. Annually we survey the tap fees and rates of the surrounding providers and we typically adjust our tap fees and rates and charges based on the average of those charged by this group. Our costs associated with the construction of water delivery systems and the production, treatment and delivery of our water are subject to market conditions and other factors, which may increase at a significantly greater rate than the prices charged by the three surrounding providers. Factors beyond our control and which cannot be predicted, such as drought, water contamination and severe weather conditions, like tornadoes and floods, may result in additional labor and material costs that may not be recoverable under our rate structure. Either increased customer demand or increased water conservation may also impact the overall cost of our operations. If the costs for construction and operation of our water services, including the cost of extracting our groundwater, exceed our revenues, we would be providing service to the Lowry Range at a loss. We may petition the Land Board for rate increases; however, there can be no assurance that the Land Board would approve a rate increase request.

We have three full time employees and may not be able to manage the increasing demands of our expanding operations.

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

We may be adversely affected by any future decision by the Colorado Public Utilities Commission to regulate us as a public utility.

The Colorado Public Utilities Commission (CPUC) regulates investor-owned water companies operating for the purpose of supplying water to the public. The CPUC regulates many aspects of public utilities operations, including establishing water rates and fees, initiating inspections, enforcement and compliance activities and assisting consumers with complaints.

We do not believe we are a public utility under Colorado law. We currently provide services by contract to the District, which supplies the public. Quasi-municipal metropolitan districts, such as the District, are exempt by statute from regulation by the CPUC. However, the CPUC could attempt to regulate us as a public utility. If this wer