PURE CYCLE CORP
Form 10-K
November 14, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended August 31, 2014

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 0-8814

PURE CYCLE CORPORATION
(Exact name of registrant as specified in its charter)

Colorado (State or other jurisdiction of incorporation or organization)	84-0705083 (I.R.S. Employer Identification No.)
1490 Lafayette St, Suite 203, Denver, CO 80218 (Address of principal executive offices) (Zip Code)	(303) 292-3456 (Registrant's telephone number, including area code)

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

Common Stock 1/3 of $.01 par value (Title of each class)	The NASDAQ Stock Market, LLC (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 [X]

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 [X]

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 [X] 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 [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant 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	[X]
Non-accelerated filer	[ ]	(Do not check if a smaller reporting company)	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 [X]

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: $107,694,594

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: November 14, 2014: 24,037,598

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III is incorporated by reference from the registrant's definitive proxy statement for the 2014 Annual Meeting of Shareholders, which will be filed with the SEC within 120 days of the close of the fiscal year ended August 31, 2014.

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“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, or incorporated by reference into this Form 10-K, are forward-looking statements that involve risk and uncertainties that could cause actual results to differ materially from projected results. The words “anticipate,” “believe,” “estimate,” “expect,” “plan,” “intend” and si 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. Our actual results could differ materially from those discussed in or implied by these forward-looking statements. Forward-looking statements include statements relating to, among other things:

- factors that may impact labor and material costs;
- loss of key employees and hiring additional personnel for our operations;
- our competitive advantage;
- negotiation of payment terms for fees;
- the sufficiency of our working capital and financing sources to fund our operations;
- intent not to hold marketable securities to create liquidity while we expand our water systems;
- need for additional production capacity;
- factors affecting demand for water;
- our ability to comply with permit requirements and environmental regulations and the cost of such compliance;
- the adequacy of the provisions in the “Lease” for the Lowry Range to cover present and future circumstances;
- estimated population increases in the Denver metropolitan area and the South Platte River basin;
- plans for the use and development of our water assets and potential delays;
- plans for office space;
- plans to retain earnings and not pay dividends;
- anticipated timing and amount of, and sources of funding for (i) capital expenditures to construct infrastructure and increase production capacities, (ii) compliance with water, environmental and other regulations, and (iii) operations including delivery and treatment of water and wastewater;
- the ability of our deep water well enhancement tool and process to increase efficiency of wells and our plans to market that product to area water providers;
- our ability to assist Colorado “Front Range” water providers in meeting current and future water needs;
- our ability to reduce the amount of up-front construction costs;
- participation in regional water projects, including “WISE”;
- timing of satisfaction of conditions to change Land Board royalties;
- regional cooperation among area water providers in the development of new water supplies and water storage, transmission and distribution systems as the most cost-effective way to expand and enhance service capacities;
- future water supply needs in Colorado;
- anticipated increases in residential and commercial demand for water services and competition for these services;
- use of raw and reclaimed water for outdoor irrigation;
- costs to treat contaminated water;
- the decreases of individual housing and economic cycles on the number of connections we can serve with our water;
- the number of new water connections needed to recover the costs of our Rangeview Water Supply and Arkansas River water assets;
- increases in future water tap fees;
- the impact of water quality, solid waste disposal and environmental regulations on our financial condition and results of operations;
- the impact of the downturn in the homebuilding and credit markets on our business and financial condition;
- environmental clean-up at the Lowry Range by the U.S. Army Corps of Engineers;

- our plans to provide water for drilling and hydraulic fracturing of oil and gas wells;
- changes in oil and gas drilling activity on our property and on Lowry Range;
- the recoverability of construction and acquisition costs from rates;

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- our belief that we are not a public utility under Colorado law;
- plans for development of our Sky Ranch property;
- renewal of leases;
- ability to generate working capital and market our water assets;
- anticipated revenues from full development of our Sky Ranch property;
- management of farms and the generation of revenues from such management including plans to increase crop yields;
- our ability to meet customer demands in a sustainable and environmentally friendly way;
- potential opposition to, and anticipated requirements of, the water court in connection with a change of use application for our Arkansas River water;
- our ability to mitigate adverse impacts to local communities from our change of use process;
- changes in unrecognized tax positions;
- forfeitures of option grants, vesting of non-vested options and the fair value of option awards;
- accounting estimates and the impact of new accounting pronouncements;
- service life of constructed facilities;
- use of third parties to construct facilities required to extend water and wastewater services;
- payment of amounts due from Sky Ranch Metropolitan District #5;
- estimated property taxes and utilization of net operating losses;
- capital expenditures for investing in expenses and assets of the District;
- impairments in carrying amounts of long-lived assets;
- the effectiveness of our disclosure controls and procedures and our internal controls over financial reporting;
- the amount of the "Tap Participation Fee" liability;
- our ability to reduce the Tap Participation Fee and recover damages from "HP A&M";
- loss of properties and water rights due to the failure to cure defaults by HP A&M;
- claims of HP A&M against the Company;
- litigation with HP A&M;
- future fluctuations in the price and trading volume of our common stock; and
- timing of the filing of our proxy statement.

Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, without limitation:

- the timing of new home construction and other development in the areas where we may sell our water, which in turn may be impacted by credit availability;
- population growth;
- employment rates;
- timing of oil and gas development in the areas where we sell our water;
- general economic conditions;
- the market price of water;
- the market price of oil and gas;
- the market price of alfalfa and other crops grown on our farms subject to crop share leases;
- changes in customer consumption patterns;
- changes in applicable statutory and regulatory requirements;
- changes in governmental policies and procedures;
- uncertainties in the estimation of water available under decrees;
- uncertainties in the estimation of costs of delivery of water and treatment of wastewater;
- uncertainties in the estimation of the service life of our systems;
- uncertainties in the estimation of costs of construction projects;
- the strength and financial resources of our competitors;

- our ability to find and retain skilled personnel;
- climatic and weather conditions, including floods, droughts and freezing conditions;
- labor relations;
- turnover of elected and appointed officials and delays caused by political concerns and government procedures;
- availability and cost of labor, material and equipment;
- delays in anticipated permit and construction dates;
- engineering and geological problems;
- environmental risks and regulations;
- our ability to raise capital;
- our ability to negotiate contracts with new customers;
- outcome of litigation and arbitration proceedings;
- uncertainties in water court rulings;
- our ability to collect on any judgments; and
- the factors described under “Risk Factors” in this Annual Report on Form 10-K.

Except for our ongoing obligation to disclose certain information under the federal securities laws, we undertake no obligation, and disclaim any obligation, to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. All forward-looking statements are expressly qualified by this cautionary statement.

PART I

Item 1 – Business Summary

Pure Cycle Corporation (“Pure Cycle”) is an investor-owned Colorado corporation that provides wholesale water and wastewater services and owns 14,900 acres of farmland that is leased to local farmers. The wholesale water and wastewater services include water production, storage, treatment, bulk transmission to retail distribution systems, wastewater collection and treatment, irrigation water treatment and transmission, construction management, billing and collection, and emergency response. We provide these services to our wholesale customers, which are typically industrial customers and local governmental entities that provide water and wastewater services to their end-use customers located in the greater Denver, Colorado metropolitan area.

We are vertically integrated, which means we own all assets necessary to provide wholesale water and wastewater services to our customers. This includes owning (i) water rights which we use to provide domestic and irrigation water to our wholesale customers (we own surface water, groundwater, reclaimed water rights and water storage rights), (ii) infrastructure (such as wells, diversion structures, pipelines, reservoirs and treatment facilities) required to withdraw, treat, store and deliver water, (iii) infrastructure required to collect, treat, store and reuse wastewater, and (iv) infrastructure required to treat and deliver reclaimed water for irrigation use.

We currently provide wholesale water service predominately to two local governmental entity customers. Our largest customer is the Rangeview Metropolitan District (the “District”), a quasi-municipal political subdivision of the State of Colorado which is described further below. We provide service to the District and its end-use customers pursuant to “The Rangeview Water Agreements” (defined below) between us and the District for the provision of wholesale water service to the District for use in the District’s service area. Through the District, we provide wholesale service to 258 Single Family Equivalent (“SFE”) (as defined below) water connections and 157 SFE wastewater connections located in southeastern metropolitan Denver. In the past two years, we have been providing an increasing amount of water to industrial customers in our service area and adjacent to our service ares to the oil and gas industry for the purposes of hydrologic fracturing. Oil & gas operators have leased more than 135,000 acres within and adjacent to our service areas for the purpose of exploring oil and gas interest in the Niobrara and other formations and this activity has led to increased water demands.

We plan to utilize our significant water assets along with our adjudicated reservoir sites, which are described in the Our Water and Land Assets section below, to provide wholesale water and wastewater services to local governmental entities. These local governmental entities will in turn provide residential and commercial water and wastewater services to communities along the eastern slope of Colorado in the area extending essentially from Fort Collins on the north to Colorado Springs on the south which is generally referred to as the “Front Range.” 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 farm land consists of approximately 14,900 acres of irrigated land currently being leased to local farmers in southeastern Colorado and we also own 931 acres of land in the I-70 corridor east of Denver, Colorado that is being held for development. These land interests are described in the Our Water and Land Assets section below.

Pure Cycle Corporation was incorporated in Delaware in 1976 and reincorporated in Colorado in 2008.

Glossary of terms

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

- Acre Foot ("aft") – approximately 326,000 gallons of water, or enough water to cover an acre of ground with one foot of water. For some instances herein, as context dictates, the term acre feet is used to designate an annual decreed amount of water available during a typical year.

- 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 (see "Retail Facilities" below) 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.

- Non-Tributary Groundwater – underground water in an aquifer which is situated so it neither draws from nor contributes to a natural surface stream in any measurable degree.

- Not Non-Tributary Groundwater – statutorily defined as groundwater located within those portions of the Dawson, Denver, Arapahoe, and Laramie-Fox hills aquifers that are outside of any designated groundwater basin in existence on January 1, 1985.

- 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 equal to 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.

- Tributary Groundwater – all water located in an aquifer that is hydrologically connected to a natural stream and is not considered non-tributary or not non-tributary.

- Tributary Surface Water – water on the surface of the ground flowing in a stream or river system.

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

Our Water and Land Assets

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

The $91.4 million of capitalized water costs on our balance sheet represents the costs of the water rights we own and the related infrastructure developed to provide wholesale water and wastewater services. Each of these assets is explained in detail below.

The illustration below indicates the approximate location of each of our assets.

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

Rangeview Water Supply and the Lowry Range

Our Rangeview Water – We own or control a total of approximately 3,300 acre feet of tributary surface water, 25,050 acre feet of non-tributary and not non-tributary groundwater rights, and approximately 26,000 acre feet of adjudicated reservoir sites that we refer to as our "Rangeview Water Supply." This water is located at the "Lowry Range," which is owned by the State Board of Land Commissioners (the "Land Board") and is described below.

We acquired our Rangeview Water Supply in April 1996 pursuant to the following agreements:

(i) The 1996 Amended and Restated Lease Agreement between the Land Board and the District which was superseded by the 2014 Amended and Restated Lease Agreement, dated July 10, 2014 (the "Lease"), among the Land Board, the District, and us;

(ii) The Agreement for Sale of non-tributary and not non-tributary groundwater which we can "export" from the Lowry Range to supply water to nearby communities (this portion of the Rangeview Water Supply is referred to as our "Export Water") between us and the District (the "Export Agreement"); and

(iii) The 1996 Service Agreement between us and the District for the provision of water service to the District's customers, which was superseded by the Amended and Restated Service Agreement, dated July 11, 2014 (the "Service Agreement"), between us and the District.

Additionally, in 1997 we entered into a Wastewater Service Agreement (the "Wastewater Agreement") with the District to provide wastewater service to the District's customers.

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

Pursuant to the Rangeview Water Agreements, we design, construct, operate and maintain the District's water and wastewater systems to allow the District to provide water and wastewater service to its customers located within the District's 24,000 acre service area at the Lowry Range. We are the exclusive water and wastewater provider on the Lowry Range, and we operate both the water and the wastewater systems during our contract period on behalf of the 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. Through facilities we own, we use our Export Water, and we intend to use other supplies owned by us, to provide wholesale water service and wastewater service to customers located outside of the Lowry Range, including customers of the District and other governmental entities, and industrial, and commercial customers.

Of the 25,050 acre feet of Lowry Range groundwater, we own 11,650 acre feet of 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 the year 2081 the remaining 13,400 acre feet of groundwater and approximately 3,300 acre feet of average yield surface water to customers either on or off of the Lowry Range. The combined 28,350 acre feet can serve approximately 70,000 SFE's based on the average use of .4 acre feet per SFE.

The Lowry Range Property – The Lowry Range is located in unincorporated Arapahoe County (the "County"), about 20 miles southeast of downtown Denver. The Lowry Range is one of the largest contiguous parcels under single ownership next to a major metropolitan area in the United States. The Lowry Range is approximately 27,000 acres in size or about 40 square miles of land. Of the 27,000 acres, pursuant to our agreements with the Land Board and the District, we have the exclusive rights to provide water and wastewater services to approximately 24,000 acres of the Lowry Range.

Rangeview Metropolitan District – The District is a quasi-municipal corporation and political subdivision of Colorado formed in 1986 for the purpose of providing water and wastewater service to the Lowry Range and other approved areas. The District is governed by an elected board of directors. Eligible voters and persons eligible to serve as directors of the District must own an interest in property within the boundaries of the District. We own certain rights and real property interests which encompass the current boundaries of the District. The current directors of the District are Mark W. Harding and Scott E. Lehman (both employees of Pure Cycle), and 2 independent board members. Pursuant to Colorado law, directors may receive $100 for each board meeting they attend, up to a maximum of $1,600 per year. Mr. Harding and Mr. Lehman have both elected to forego these payments.

South Metropolitan Water Supply Authority – The South Metropolitan Water Supply Authority ("SMWSA") is a municipal water authority in the State of Colorado organized to pursue the acquisition and development of new water supplies on behalf of its members. SMWSA members include 14 Denver area water providers in Arapahoe and Douglas Counties. The District became a member of SMWSA in 2009 in an effort to participate with other area water providers in developing regional water supplies along the Front Range. For over three years, the SMWSA members have been working with Denver Water and Aurora Water on a cooperative water project known as the Water Infrastructure Supply Efficiency partnership (“WISE”), which seeks to develop regional infrastructure which would interconnect members’ water transmission systems to be able to develop additional water supplies from the South Platte River in conjunction with Denver Water and Aurora Water. In July of 2013, the District together with nine other SMWSA members formed the South Metropolitan Wise Authority (“SMWA”) to continue to develop the WISE project. Through an agreement with the District, we continue to support SMWA and its joint water development efforts, and in October of 2014, we purchased certain rights to existing pipelines and related infrastructure acquired by the WISE project.

East Cherry Creek Valley System – Pursuant to a 1982 contractual right, the District may purchase water produced from East Cherry Creek Valley Water and Sanitation District's ("ECCV") Land Board system. ECCV's Land Board system is comprised of eight wells and over ten miles of buried water pipeline located on the Lowry Range. In May 2012, in our capacity as Rangeview's service provider and the Export Water Contractor (as defined in the Lease), we entered into an agreement to operate and maintain the ECCV facilities and we can utilize the system to provide water to commercial and industrial customers, including customers providing water for drilling and hydraulic fracturing of oil and gas wells. Between August 2012 and May 2014 we rehabilitated six wells in the ECCV system and we currently operate each of the wells. The current capacity for the ECCV system is approximately 500 gallons per minute or approximately .75 million gallons per day. During the fiscal years ended August 31, 2014 and 2013, we produced approximately 132.1 million gallons and 26.2 million gallons, respectively through the ECCV system.

Hydraulic fracturing – Water revenues from sales of drilling and fracking water for wells drilled into the Niobrara Formation were approximately $1.7 million and $326,000 during the fiscal years ended August 31, 2014 and 2013, respectively. With a large percentage of the acreage surrounding the Lowry Range in Arapahoe, Adams, Elbert, and portions of Douglas Counties already leased by major oil companies, we anticipate providing additional water for drilling and hydraulic fracturing ("fracking") of oil and gas wells in the coming fiscal year. We sell water directly to ConocoPhillips Company ("ConocoPhillips"), the largest oil and gas lease holder operating in the area and indirectly to ConocoPhillips through Select Energy Services, LLC ("Select").

In order to service this demand we have significantly increased the capacity of our system over the previous two fiscal years. During the fiscal year ended August 31, 2013 we rehabilitated five of our ECCV wells, and we added approximately 2,500 ft of 8" buried line so that we can deliver water directly to the industry both on and off of the Lowry Range. During the fiscal year ended August 31, 2014 we drilled one well on the Lowry Range and two wells on our Sky Ranch property, which added approximately .5 million gallons of water per day to our system. During the fiscal year ended August 31, 2014 we rehabilitated an additional ECCV well and we constructed a 400,000 barrel storage reservoir at our Sky Ranch property. Collectively our system capacity, has been increased to approximately 1.2 million gallons per day. At present there is one drilling rig working the area, which over the past 12 months has been drilling and fracking 1 well approximately every 4 weeks. The amount of water used for each fracked well ranges between 7 and 12 million gallons. During fiscal 2014 and 2013 we sold approximately 504.8 aft and 106.5 aft, respectively. Monthly water deliveries to the industry are detailed in the following chart.

Land Board Royalties – Pursuant to the Rangeview Water Agreements, the Land Board is entitled to royalty payments based on a percentage of revenues earned from water sales that utilize water from the Rangeview Water Supply. The calculation of royalties depends on the water source, and whether the customer is a public or private entity. Royalties were modified in July 2014 pursuant to the terms of the Lease. The Land Board does not receive a royalty from wastewater services.

Water Customers – When we develop, operate and deliver water service, payments from customers generate royalties to the Land Board at a rate of 12% of gross revenues from private customers and 10% from public entity customers. In the event that either (i) metered production of water used on the Lowry Range in any calendar year exceeds 13,000 acre feet or (ii) 10,000 surface acres on the Lowry Range have been rezoned to non-agricultural use, finally platted and water tap agreements have been entered into with respect to all improvements to be constructed on such acreage, the Land Board may elect, at its option, to receive, in lieu of its royalty of 10% or 12% of gross revenues (depending on whether the customer is public or private), 50% of the collective net profits (ours and the District's) derived from the sale or other disposition of water on the Lowry Range. To date neither of these conditions has been met and such conditions are not likely to be met any time soon. In addition to royalties on the sale of metered water deliveries, the Land Board will receive a royalty on the sale of water taps at the rate of 2% of the gross amount received from the sale of a water tap.

Sale of Water Rights – In the event we sell our Export Water right outright rather than developing and delivering water service, royalties to the Land Board escalate based on the amount of gross 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 A.

Table A - Royalties for Sale of Water Rights

	Royalty Rate	
Gross Revenues	Private Entity Buyer	Public Entity Buyer
$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%

Arkansas River Water and Land

We own approximately 51,000 acre feet of surface water rights in the Arkansas River together with approximately 14,900 acres of farm land in southeastern Colorado, of which approximately 11,800 (79%) is irrigated. The water rights we own are represented by 18,656 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 and Lamar, Colorado. Mineral rights on these farms, if any, are owned approximately 75% by High Plains A&M, LLC ("HP A&M"), and 25% by us. We acquired our Arkansas River water and land from HP A&M pursuant to an Asset Purchase Agreement dated May 10, 2006 (the "Arkansas River Agreement").

We currently lease our land and water to area farmers who irrigate the land for agricultural purposes. We intend to continue managing our farms together with our tenant farmers. For additional information concerning our rights and obligations under the Arkansas River Agreement and a discussion of the effect of the defaults by HP A&M, see Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Use of Estimates – Fair Value Estimates – Obligations Payable by HP A&M, Now in Default and – Farm Accounts Receivable and Future Farm Income.

Agricultural Operations and Leasing – Beginning on August 3, 2012, we assumed management of our farm operations and all associated income and expenses. Beginning September 1, 2012, we began tracking and reporting our farm operations as a separate business segment to reflect management's analysis, investment decision, and operating performance for this business segment. Based on acreage, approximately 85% of our farm operations are managed through cash lease arrangements with local area farmers whereby we charge a fixed fee, billed semi-annually in March and November, to lease our land and water rights for agricultural purposes. Based on acreage, approximately 15% of our farm operations are managed through crop share leases, pursuant to which we and the tenant farmer jointly share in the gross revenues generated from the crops grown under a 75% farmer, 25% landlord participation. The majority of crops grown on our farms are alfalfa, with a number of acres also planted in corn, sorghum, and wheat. We will continue to review and evaluate ways to enhance the performance of our approximately 14,900 acres of farm land through relationships with area farmers.

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Tap Participation Fee – As further described in Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Use of Estimates below and Note 7 – Long-Term Debt and Operating Lease and Note 15 – Subsequent Events to the accompanying financial statements, we agreed to pay HP A&M 10% of the tap fees we receive from the next 40,000 water taps we sell from and after the original date of the Arkansas River Agreement. This is referred to as the "Tap Participation Fee", or "TPF." The TPF is payable when we sell water taps and receive funds from such water tap sales or other dispositions of property purchased in the HP A&M acquisition.

Effective as of September 1, 2011, (i) HP A&M elected to increase the TPF percentage from 10% to 20% and take a corresponding 50% reduction in the number of taps subject to the TPF and (ii) pursuant to the Property Management Agreement, we began allocating 26.9% of the Net Revenues (defined as all lease and related income received from the farms less employee expenses, direct expenses for managing the leases and a reasonable overhead allocation) paid to HP A&M against the TPF.

Approximately 60 of the 80 farms acquired from HP A&M were subject to deeds of trust to secure payment of promissory notes owed by HP A&M to third parties (the "Excluded Indebtedness"). We did not assume any of these promissory notes and are not legally responsible for making any of the required payments under these notes. This responsibility remains solely with HP A&M. The farms subject to the deeds of trust consisted of approximately 14,000 acres of farm land and 16,882 FLCC shares of water rights. Beginning in June of 2012, HP A&M began defaulting on the promissory notes owed to third parties resulting in a default under the Arkansas River Agreements and related agreements. As of September 1, 2012 HP A&M owed approximately $9.6 million of principal and accrued interest on the defaulted notes. As of the date of this filing, HP A&M has defaulted on all of these promissory notes and deeds of trust.

We have commenced exercising our remedies under the Arkansas River Agreement and related agreements, which remedies include, but are not limited to, the right to (i) foreclose on 1,500,000 shares of Pure Cycle common stock issued to HP A&M and the proceeds therefrom (the "Pledged Shares") which were pledged by HP A&M pursuant to a pledge agreement (the "Seller Pledge Agreement") to secure the payment and performance by HP A&M of the promissory notes described above (these shares were sold in a foreclosure sale in September 2012); (ii) reduce the Tap Participation Fee; (iii) terminate the Property Management Agreement, which we terminated on August 3, 2012; (iv) stop allocating 26.9% of the Net Revenues to the TPF; and (v) recover damages caused by the defaults, including certain costs and attorneys' fees. See Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Use of Estimates - Fair Value Estimates – Obligations Payable by HP A&M, Now in Default below for further discussion of the defaults by HP A&M and the remedies under the Arkansas River Agreement, as well as Note 7 – Long-Term Debt and Operating Lease and Note 15 – Subsequent Events to the accompanying financial statements.

During the 2013 and 2014 fiscal years 35 farms and three FLLC certificates representing water rights only went through foreclosure proceedings due to the defaults by HP A&M. Our agreement with HP A&M provides for a reduction of the number of water taps subject to the TPF payable to HP A&M in the event the farms or water rights are sold in a foreclosure sale. We reduced the number of taps subject to the TPF by 17,243 taps and the discounted present value of the TPF payable by a total of approximately $65.1 million as a result of the foreclosures. As of August 31, 2014 there were 2,184 taps subject to the Tap Participation Fee. Subsequent to our fiscal year end, an additional two farms were foreclosed resulting in a reduction of the number of taps subject to the TPF by an additional 1,801 taps (approximately $6.7 million of the TPF), leaving 383 taps subject to the Tap Participation Fee.

Sky Ranch

In 2010 we purchased approximately 931 acres of undeveloped land located in unincorporated Arapahoe County known as Sky Ranch. Sky Ranch is located directly adjacent to I-70, 16 miles east of downtown Denver, 4 miles north of the Lowry Range, and 4 miles south of Denver International Airport.

The property includes rights to 820 acre feet of water, approximately 640 acres of oil & gas mineral rights, and has been zoned for residential, commercial and retail uses which may include up to 4,850 SFE's. There is currently no development at Sky Ranch. We currently lease the land to an area farmer and have leased the minerals to ConocoPhillips. We envision that when development at Sky Ranch begins, the development will be in the form of entry level housing (houses costing less than $300,000); however, we are still evaluating the best use for the property. We plan to partner with home builders/developers to develop the Sky Ranch property. We are anticipating that the home builder/developer will construct infrastructure such as roads, curbs and gutters, and we will construct the necessary water and wastewater systems. Our plan is to provide the market with competitively priced lots that are ready for development together with affordable, sustainable, environmentally sound water and wastewater services. Although timing for development of this property is unknown, some land development experts believe the entry level housing market is among the most active housing products in the Denver metropolitan area. At full development, the water and wastewater utilities at Sky Ranch are anticipated to generate in excess of $145 million in tap fee revenue and approximately $7.5 million annually in wholesale water and wastewater service fee revenue (based on current fees and charges).

Oil and Gas Lease – On March 10, 2011, we entered into a Paid-Up Oil and Gas Lease (the "O&G Lease") and Surface Use and Damage Agreement (the "Surface Use Agreement") with Anadarko E&P Company, L.P. ("Anadarko"), a wholly owned subsidiary of Anadarko Petroleum Company. The O&G Lease seeks to capitalize on the growing interest in the region's Niobrara Oil Formation. Pursuant to the O&G Lease, we received an up-front payment of $1,900 per net mineral leased acre, or $1,243,400, and 20% of gross proceeds royalty (less certain taxes) from the sale of any oil and gas produced from our property. In December of 2012 the O&G Lease was purchased by a wholly owned subsidiary of ConocoPhillips. The O&G Lease had a term of three (3) years commencing on March

10, 2011. The lease was extended for an additional two (2) years and we received an additional up-front payment for the extension of $1,243,400. Pursuant to the Surface Use Agreement, ConocoPhillips may drill on up to three well pad sites on the Sky Ranch property covered under the O&G Lease. Additionally, we will receive $3,000 per acre for land that is permanently disturbed for use in the oil and gas exploration and production. During October 2013, ConocoPhillips filed three well permit applications. One permit is for a well to be drilled on the Sky Ranch property. Drilling of this the first well was completed in September 2014. The remaining two permits are for wells to be drilled off of Sky Ranch, but will be drilled into the formation under the Sky Ranch property.

We have experienced increased water demands for hydraulic fracturing of oil and gas wells being developed in the Niobrara Formation around our Sky Ranch property and the Land Board's Lowry Range property. Current wells developed in the Niobrara Formation that we are serving are utilizing between 7 and 12 million gallons of water to drill and frack, which equates to selling water to between approximately 53 and 92 SFE's.

Arapahoe County Fairgrounds Agreement for Water Service

In 2005, we entered into an Agreement for Water Service (the "County Agreement") with the County to design, construct, operate and maintain a water system for, and provide water services to, the County for use at the County's fairgrounds (the "Fairgrounds"), which are located west of the Lowry Range. Pursuant to the County Agreement we purchased 321 acre feet of water from the County in 2008. Further details of the arrangements with the County are described in Note 4 – Water and Land Assets to the accompanying financial statements.

Pursuant to the County Agreement we constructed and own a deep water well, a 500,000 gallon water tank and pipelines to transport water to the Fairgrounds. The construction of these items was completed in our fiscal 2006, and we began providing water service to the County in 2006.

Well Enhancement and Recovery Systems

In January 2007, we, along with two other parties, 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 completed into the Denver Basin groundwater formation. In 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 results from studies performed by an independent hydro-geologist, the well enhancement tool effectively increased the production of the two test wells by 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 are marketing the tool to area water providers. On April 27, 2010, we and the other remaining owner of Well Enhancement LLC acquired the third partner's 1/3rd interest in Well Enhancement LLC. Following the acquisition, the remaining partners each hold a 50% interest in Well Enhancement LLC. We used our tool on three wells and one well during our fiscal 2013 and our fiscal 2014, respectively.

Revenues

We generate revenues through two separate lines of businesses including our Wholesale Water and Wastewater business and our Farming Operations, which are described below.

Wholesale Water and Wastewater business – We generate revenues through our wholesale water and wastewater segment predominately from three sources: (i) monthly service and contract delivery fees, (ii) one time water and wastewater tap fees and construction fees, and (iii) consulting fees. Our revenue sources and how we account for them are described in greater detail below. We typically negotiate the payment terms for tap fees, construction fees, and other water and wastewater service fees with our wholesale customers as a component of our service agreements prior to construction of the project. However, with respect to customers on the Lowry Range, pursuant to the Lease, the District's rates and charges to such end-use customers may not exceed the average of similar rates and charges of three nearby water providers.

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i) Monthly Service Fees – Monthly wholesale water usage fees are assessed to our customers based on actual metered deliveries to their end-use customers each month. Water usage fees are based on a tiered pricing structure that provides for higher prices as customers use greater amounts of water. The District changed its water usage fees on December 31, 2013. The water usage fees for end-use customers on the Lowry Range are noted below in table B:

Table B - Tiered Water Usage Pricing Structure

	Price ($ per thousand gallons)		
Amount of consumption	2014	2013	2012
Base charge per SFE	$30.35	$27.62	$27.62
0 gallons to 10,000 gallons	$3.51	$2.81	$2.81
10,001 gallons to 20,000 gallons	$5.31	$3.69	$3.69
20,001 gallons to 40,000 gallons	$8.12	$6.56	$6.56
40,001 gallons and above	$9.55	$8.93	$8.93

The figures in Table B reflect the amounts charged to the District's end-use customers. In exchange for providing water service to the District's Lowry Range customers, we receive 98% of the usage charges received by the District relating to water services after deducting the required royalty to the Land Board (described above at Rangeview Water Supply and Lowry Range – Land Board Royalties). In exchange for providing wastewater services, we receive 90% of the District's monthly wastewater service fees, as well as the right to use or sell the reclaimed water.

Effective December 31, 2013 the District began charging its wastewater customers based on a monthly fee of $10.05 per SFE plus a $7.40 per thousand gallons treated usage fee. Prior to December 31, 2013 the District was charging $7.83 per SFE plus a $6.68 per thousand gallons treated usage fee, which were rates that had been in place since July 1, 2011.

In addition to the tiered water usage pricing structure we currently charge a hydrant rate of $10.50 per thousand gallons. We also collect other immaterial fees and charges from customers and other users to cover miscellaneous administrative and service expenses, such as application fees, review fees and permit fees.

ii) Water and Wastewater Tap Fees and Construction Fees – Tap fees are typically paid by developers in advance of construction activities and are non-refundable. Tap fees are typically used to fund construction of the Wholesale Facilities and defray the acquisition costs of obtaining water rights.

Effective December 31, 2013, the District increased water tap fees from $22,500 to $24,620, which was a 9.4% increase. The District also increased wastewater tap fees from $4,883 to $4,988 effective December 31, 2013. The District last increased water tap fees on July 1, 2009 from $21,500 to $22,500 per SFE, which was a 4.7% increase over the 2008 water tap fee.

In exchange for providing water service to the District's customers on the Lowry Range, we receive 100% of the District's tap fees after deducting the required royalty to the Land Board described above. In exchange for providing wastewater services, we receive 100% of the District's wastewater tap fees.

Construction fees are fees we receive, typically in advance, from developers for us to build certain infrastructure such as Special Facilities which are normally the responsibility of the developer.

iii) Consulting Fees – Consulting fees are fees we receive, typically on a monthly basis, from municipalities and area water providers along the I-70 corridor, for system management and maintenance.

Farming Operations – We lease our farms to local area farmers on both a cash and a crop share lease basis. Our cash lease farmers are charged a fixed fee, billed semi-annually in March and November. During the November billing cycle our cash lease billings include either a discount or a premium adjustment based on actual water deliveries by the FLCC. Our crop share lease fees are based on actual crop yields and are received upon the sale of the crops. All fees are estimated and recognized ratably on a monthly basis.

Significant Customers

Our wholesale water and wastewater sales to the District pursuant to the Rangeview Water Agreements accounted for 9%, 34% and 86% of our total water revenues for the years ended August 31, 2014, 2013 and 2012, respectively. The District has one significant customer, the Ridgeview Youth Services Center ("Ridgeview"). Pursuant to our Rangeview Water Agreements with the District, we are providing water to Ridgeview on behalf of the District. Ridgeview accounted for 8%, 28% and 53% of our total water revenues for the years ended August 31, 2014, 2013 and 2012, respectively.

Our wholesale water sales directly and indirectly to ConocoPhillips accounted for approximately 88%, 59% and 0% of our total water revenues for the fiscal years ended August 31, 2014, 2013 and 2012, respectively.

Our Projected Operations

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

Along the Colorado Front Range, there are over 70 water providers with varying needs for replacement and new water supplies. We believe we are well positioned to assist certain of these providers in meeting their current and future water needs.

We design, construct and operate our water and wastewater facilities using advanced water purification and wastewater treatment technologies which allow us to use our water supplies in an efficient and environmentally sustainable manner. We plan to develop our water and wastewater systems in stages to efficiently meet demands in our service areas, thereby reducing the amount of up-front capital costs required for construction of facilities. We use third party contractors to construct our facilities as needed. We employ licensed water and wastewater operators to operate our water and wastewater systems. As our systems expand, we expect to hire additional personnel to operate our systems, which include water production, treatment, testing, storage, distribution, metering, billing, and operations management.

Our water and wastewater systems conjunctively use surface and groundwater supplies and storage of raw water and highly treated effluent supplies to provide a balanced sustainable water supply for our wholesale customers and their end-use customers. Integrating conservation practices and incentives together with effective water reuse demonstrates our commitment to providing environmentally responsible, sustainable water and wastewater services. Water supplies and water storage reservoirs are competitively sought throughout the west and along the Front Range of Colorado. We believe regional cooperation among area water providers in developing new water supplies, water storage, and transmission and distribution systems, provides the most cost effective way of expanding and enhancing service capacities for area water providers. We continue to discuss developing water supplies and water storage opportunities with area water providers.

We expect the development of our Rangeview Water Supply to require a significant number of high capacity deep water wells. We anticipate drilling separate wells into each of the three principal aquifers located beneath the Lowry Range. 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) for storage in reservoirs to be constructed on the Lowry Range. Based on preliminary engineering estimates, the full build-out of water facilities (including diversion structures, transmission pipelines, reservoirs, and water treatment facilities) on the Lowry Range will cost in excess of $340 million, based on estimated costs, and will accommodate water service to customers located on and outside the Lowry Range. We expect this build out to occur over an extended period of time, and we expect that tap fees will be sufficient to fund the infrastructure costs.

Our Denver based supplies are a valuable, locally available resource located near the point of use. This enables us to incrementally develop infrastructure to produce, treat and deliver water to customers based on their growing demands. 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.

In order to use our Arkansas River water for municipal purposes, we must file a change of use application with the Colorado 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 130-mile pipeline, and water treatment and pumping facilities, from southeastern Colorado to the Denver metropolitan area at an estimated cost of over $700 million. Since acquiring the Arkansas River supply, we have investigated various pipeline alignments and potential partnerships for construction of these facilities. We do not plan on beginning this process in the near term and anticipate that the tap fees and usage fees we generate from taps sold utilizing our water rights located along the Front Range, along with funding from other pipeline partners, will be sufficient to fund the water delivery facilities when the water is needed along the Front Range. 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 who have assembled to study alternatives to traditional "buy and dry" agricultural-to-municipal water transfers.

During fiscal 2014 we, along with the District drilled three new wells, added a storage pond and added related piping, vaults, and control mechanisms. These efforts increased the capacity of our wholesale non-potable water system to approximately 1.2 million gallons per day. We may need to add additional wells if demand continues to grow, and we are anticipating adding substantial piping to connect our Rangeview and Sky Ranch systems.

The District is currently in the process of developing the WISE project. This project is being established for the purpose of developing infrastructure to interconnect provider's water systems and to extend renewable water sources owned by Denver Water and Aurora Water to the South Metro water providers, including the District. This system will add an additional vital source of water to our system and will enable the providers to move water among each other, which will be an essential component of the District's and our systems and will enable us to continue to meet the demands of our customers and expand opportunities to serve other customers on a sustainable and environmentally friendly manner. Through our funding agreement with the District (see Note 14 – Related Party Transactions) and subsequent to fiscal year end, we purchased certain rights to use existing water transmission and related infrastructure acquired by the WISE project, and anticipate that we will be investing in this system during fiscal 2015 and beyond.

We are exploring development of our Sky Ranch property including evaluating possible joint venture opportunities whereby we would contribute the property, a portion of the development funds, and build the water and wastewater infrastructure for housing and commercial development of the property. The timing for us to begin developing the property is largely dependent on the Denver real estate market and interest we receive from home builders and developers. While the Denver area's housing market has strengthened in recent years we are not able to determine when we expect to begin development of the property.

We continue to develop our farming operations seeking to increase crop yields and to balance our cash and crop share leases in order to maximize profits. We are evaluating options to add sprinkler irrigation to a few of our farms during next two to three years in order to better utilize our water supplies and increase crop yields. We are also negotiating with area farmers to optimize our lease structure.

Water and Growth in Colorado

After experiencing a weak economy through 2012, much like that of the U.S. as a whole, Colorado began recovering during 2013 and 2014. The key drivers in our business model are:

- Housing Starts – From September 2012 to September 2013 the annual housing starts increased by 34%. From September 2013 to September 2014 the annual housing starts increased by 14%.
- Unemployment – The unemployment rate in Colorado was 5.1% at August 31, 2014 compared to a national unemployment rate of 6.1%. Colorado added an estimated 43,300 jobs from August 2013 to August 2014.
- Population – The Denver Regional Council of Governments ("DRCOG"), a voluntary association of over 50 county and municipal governments in the Denver metropolitan area, continues to estimate 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 Statewide Water Supply Initiative report by the Colorado Water Conservation Board estimates that the South Platte River basin, which includes the Denver metropolitan region, will grow from a current population of 3.2 million to 4.9 million by the year 2030; while the State's population will increase from 4.7 million to 7.2 million.
- Demand – Approximately 70% of the State's projected population increase is anticipated to occur within the South Platte River basin. Significant increases in Colorado's population, particularly in the Denver metro region and other areas in the water short South Platte River basin, together with increasing agricultural, recreational, and environmental water demands will intensify competition for water supplies. The estimated population increases are expected to result in demands for water services in excess of the current capabilities of municipal service providers, especially during drought conditions.
- Supply – The Statewide Water Supply Initiative estimates that population growth in the Denver region and the South Platte River basin will result in additional water supply demands of over 400,000 acre feet by the year 2030.
- Development – Colorado law requires property developers to demonstrate they have sufficient water supplies for their proposed projects before rezoning or annexation applications will be considered. These factors indicate that water and availability of water will continue to be critical to growth prospects for the region and the state, and that competition for available sources of water will continue to intensify. We focus the marketing of our water supplies and services to developers and 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. The District's rules and regulations for water and wastewater service call for adherence to strict conservation measures, including low flow water fixtures, high efficiency appliances, and advanced irrigation control devices. Additionally, our systems are designed and constructed using a dual-pipe water distribution system to segregate the delivery of high quality potable drinking water to our local governmental entities and their end-use customers through one system and a second system to supply raw or reclaimed water for irrigation demands. About one-half of the water used by a typical Denver-area residential water customer is used for outdoor landscape and lawn irrigation. We believe that raw or reclaimed water supplies provide the lowest cost, most environmentally sustainable water for outdoor irrigation. We expect our systems to include an extensive water reclamation system, in which essentially all effluent water from wastewater treatment plants will be reused to meet non-potable water demands. Our dual-distribution systems demonstrate our commitment to environmentally responsible water management policies in our water short region.

Competition

We negotiate individual service agreements with our governmental customers and with their developers and/or homebuilders, to design, construct and operate water and wastewater systems and to provide services to end-use customers of governmental entities and to commercial and industrial customers. These service agreements address all aspects of the development of the water and wastewater systems including:

(i) the purchase of water and wastewater taps in exchange for our obligation to construct certain Wholesale Facilities,

(ii) the establishment of payment terms, timing, capacity and location of Special Facilities (if any); and

(iii)

specific terms related to our provision of ongoing water and wastewater services to our local governmental customers as well as the governmental entity's end-use customers.

Although we have exclusive long-term water and wastewater service contracts for 24,000 acres of the 27,000-acre Lowry Range pursuant to the Service Agreement, providing water and wastewater services to areas other than Sky Ranch and the majority of the Lowry Range, is subject to competition. Alternate sources of water are available, principally from other private parties, such as farmers or others owning water rights that have historically been used for agriculture, and from municipalities seeking to annex new development areas in order to increase their tax base. Our principal competition in areas close to the Lowry Range is the City of Aurora. Principal factors affecting competition for potential purchasers of our 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 (including the cost of required taps), and the reliability of the water supply during drought periods. We estimate that the water assets we own and have the exclusive right to use have a supply capacity of approximately 155,000 SFE units, and we believe they provide us with a significant competitive advantage along the Front Range. Our legal rights to the Rangeview Water Supply have been confirmed for municipal use and 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.

Environmental, Health and Safety Regulation

Provision of water and wastewater services is subject to regulation under the federal Safe Drinking Water Act, the Clean Water Act, related state laws, and federal and state regulations issued under these laws. These laws and regulations establish criteria and standards for drinking water and for wastewater discharges. In addition, we are subject to federal and state laws and other regulations relating to solid waste disposal and certain other aspects of our operations.

Environmental compliance issues may arise in the normal course of operations or as a result of regulatory changes. We attempt to align capital budgeting and expenditures to address these issues in a timely manner.

Safe Drinking Water Act – The Safe Drinking Water Act establishes criteria and procedures for the U.S. Environmental Protection Agency (the “EPA”) to develop national quality standards for drinking water. Regulations issued pursuant to the Safe Drinking Water Act and its amendments set standards on the amount of certain microbial and chemical contaminants and radionuclides allowable in drinking water. The State of Colorado has assumed primary responsibility for enforcing the standards established by the Safe Drinking Water Act and has adopted the Colorado Primary Drinking Water Standards (5 CCR 1003-1). Current requirements for drinking water are not expected to have a material impact on our financial condition or results of operations as we have made and are making investments to meet existing water quality standards. In the future, we might be required to change our method of treating drinking water and make additional capital investments if additional regulations become effective.

The federal Groundwater Rule became effective December 1, 2009. This rule requires additional testing of water from well sources and under certain circumstances requires demonstration and maintenance of effective disinfection. In 2009, Colorado adopted Article 13 to the Colorado Primary Drinking Water Standards to establish monitoring and compliance criteria for the Groundwater Rule. We have implemented measures to comply with the Groundwater Rule.

Clean Water Act – The Clean Water Act regulates wastewater discharges from drinking water and wastewater treatment facilities and storm water discharges into lakes, rivers, streams, and groundwater. The State of Colorado has assumed primary responsibility for enforcing the standards established by the federal Clean Water Act for wastewater discharges from domestic water and wastewater treatment facilities and has adopted the Colorado Water Quality Control Act and related regulations. It is our policy to obtain and maintain all required permits and approvals for discharges from our water and wastewater facilities and to comply with all conditions of those permits and other regulatory requirements. A program is in place to monitor facilities for compliance with permitting, monitoring and reporting for wastewater discharges. From time to time, discharge violations might occur which might result in fines and penalties; but we have no reason to believe that any such fines or penalties are pending or will be assessed.

In the future, we anticipate changing our method of treating wastewater, which will require future additional capital investments, as additional regulations become effective. We anticipate spending between $400,000 and $500,000 during fiscal year 2015 for improvements at our wastewater treatment facilities necessary to maintain compliant operations in light of more stringent discharge criteria for ammonia-nitrogen and chlorine residual.

Solid Waste Disposal – The handling and disposal of residuals and solid waste generated from water and wastewater treatment facilities is governed by federal and state laws and regulations. We have a program in place to monitor our facilities for compliance with regulatory requirements, and we do not anticipate that costs associated with our handling and disposal of waste material from our water and wastewater operations will have a material impact on our business or financial condition.

Employees

We currently have seven full-time employees.

Available Information and Website Address

Our website address is www.purecyclewater.com. We make available free of charge through our website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to these reports as soon as reasonably practicable after filing with the Securities and Exchange Commission ("SEC").

These reports and all other material we file with the SEC may be obtained directly from the SEC's website, www.sec.gov/edgar/searchedgar/companysearch.html, under CIK code 276720. The contents of our website are not incorporated by reference into this report. You may also read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. Operating information for the Public Reference Room is available by calling the SEC at 1-800-SEC-0330.

Item 1A – Risk Factors

The following section describes the material risks and uncertainties that management believes could have a material adverse effect on our business, financial condition, results of operations, and the market price of our common stock. The risks discussed below include forward-looking statements, and our actual results may differ materially from those discussed in these forward-looking statements. These risks should be read in conjunction with the other information set forth in this report, including the accompanying financial statements and notes thereto.

Our net losses may continue and we may not have sufficient liquidity to pursue our business objectives. We have experienced significant net losses, 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 $30.4 million to support our operations through (i) the issuance of $25.2 million of common stock (includes the issuance of stock pursuant to the exercise of options, net of expenses) and (ii) the issuance of $5.2 million of Convertible Debt, which was converted to common stock on January 11, 2011. Our ability to fund our operational needs and meet our business objectives will depend on our ability to generate cash from future operations. We currently have a limited number of customers. 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. Recent economic conditions and disruptions have caused substantial volatility in capital markets, including credit markets and the banking industry, and have increased the cost and significantly reduced the availability of financing, which may continue or worsen in the future. There can be no assurance that financing will be available on acceptable terms or at all.

The rates the District is 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 charged by the District for water service on the Lowry Range are subject to pricing regulations set forth in the Lease with the Land Board. Both the tap fees and usage rates and charges are capped at the average of the rates of three nearby water providers. Annually the District surveys the tap fees and rates of the three nearby providers and the

District may adjust tap fees and rates and charges for water service on the Lowry Range based on the average of those charged by this group, and we receive 98% of whatever the District charges its customers. Our costs associated with the construction of water delivery systems and the production, treatment and delivery of water are subject to market conditions and other factors, which may increase at a significantly greater rate than the fees we receive from the District. Factors beyond our control and which cannot be predicted, such as government regulations, insurance and labor markets, drought, water contamination and severe weather conditions, like tornadoes and floods, may result in additional labor and material costs that may not be recoverable under the current rate structure. 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 wholesale water services, including the cost of extracting our groundwater, exceed our revenues, we would be providing service to the District for use at the Lowry Range at a loss. The District may petition the Land Board for rate increases; however, there can be no assurance that the Land Board would approve a rate increase request. Further, even if a rate increase were approved, it might not be granted in a timely manner or in an amount sufficient to cover the expenses for which the rate increase was sought.

Our business is subject to seasonal fluctuations and weather conditions which could affect demand for our water service and our revenues. We depend on an adequate water supply to meet the present and future demands of our customers and their end-use customers and to continue our expansion efforts. Conditions beyond our control may interfere with our water supply sources. Drought and overuse may limit the availability of water. These factors might adversely affect our ability to supply water in sufficient quantities to our customers and our revenues and earnings may be adversely affected. Additionally, cool and wet weather, as well as drought restrictions and our customers' conservation efforts, may reduce consumption demands, also adversely affecting our revenue and earnings. Furthermore, freezing weather may contribute to water transmission interruptions caused by pipe and main breakage. If we experience an interruption in our water supply, it could have a material adverse effect on our financial condition and results of operations. Demand for our water during the warmer months is generally greater than during cooler months due primarily to additional requirements for water in connection with cooling systems, irrigation systems and other outside water use. Throughout the year, and particularly during typically warmer months, demand will vary with temperature and rainfall levels. If temperatures during the typically warmer months are cooler than expected or there is more rainfall than expected, the demand for our water may decrease and adversely affect our revenues.

Sales to the fracking industry could be curtailed or eliminated in the future. Our water sales are highly concentrated directly and indirectly with one company providing fracking services to the oil and gas industry on and around the Lowry Range and our Sky Ranch property. Regulations, fracking technologies, and the success of the wells are conditions that could limit or eliminate our sales to this customer base as well as renewals of our oil and gas leases, if any, in the future. Investment in oil and gas development is dependent on the price of oil and, recently, the price of oil has decreased significantly. We have no contractual commitment that will ensure these sales will continue in the future.

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 our customers. 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 or other infrastructure to deliver the water to the Front Range, which is anticipated to cost over $700 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.

We are dependent on the housing market and development in our targeted service areas for future revenues. Providing wholesale water service using our Colorado Front Range water supplies is our principal source of future revenue. The timing and amount of these revenues will depend significantly on housing developments being built near our water assets. The development of these areas is not within our control, and 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. In the event wholesale water sales are not forthcoming or development on the Lowry Range, Sky Ranch or other developments in our targeted service area 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. After several years of significant declines in new home construction, there have been positive market gains in the Colorado housing market in 2013 and 2014. However, if the downturn in the homebuilding and credit markets return or if the national economy weakens and economic concerns intensify, it could have a significant negative impact on our business and financial condition.

Development on the Lowry Range is not within our control and is subject to obstacles. Development on the Lowry Range is controlled by the Land Board, which consists of a five person citizen group representing education, agriculture, local government and natural resources, plus one at-large commissioner, each appointed for a four-year term by the Colorado governor and approved by the Colorado Senate. The Land Board's focus with respect to issues such as development and conservation on the Lowry Range tends to change as membership on the Land Board changes. In addition, there are often significant delays on the adoption and implementation of plans with respect to property administered by the Land Board because the process involves many constituencies with diverse interests. In the event water sales are not forthcoming or development of the Lowry Range is delayed or abandoned, we may incur additional short or long-term debt obligations or seek to sell additional equity to generate operating capital.

Because of the prior use of the Lowry Range as a military facility, environmental clean-up may be required prior to development, including the removal of unexploded ordnance. The U.S. Army Corps of Engineers have been conducting unexploded ordnance removal activities at the Lowry Range for the past 20 years. Continued activities are dependent on federal appropriations, and the Army Corps of Engineers has no assurance from year to year of such appropriations for its activities at the Lowry Range.

In order to utilize our Arkansas River water, 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.

Our construction of water and wastewater projects may expose us to certain completion, performance and financial risks. We intend to rely on independent contractors to construct our water and wastewater facilities. These construction activities may involve risks, including shortages of materials and labor, work stoppages, labor relations disputes, weather interference, engineering, environmental, permitting or geological problems and unanticipated cost increases. These issues could give rise to delays, cost overruns or performance deficiencies, or otherwise adversely affect the construction or operation of our water and wastewater delivery systems. In addition, we may experience quality problems in the construction of our systems and facilities, including equipment failures. We cannot assure you that we will not face claims from customers or others regarding product quality and installation of equipment placed in service by contractors.

Certain of our contracts may be fixed-price contracts, in which we may bear all or a significant portion of the risk for cost overruns. Under these fixed-price contracts, contract prices are established in part based on fixed, firm subcontractor quotes on contracts and on cost and scheduling estimates. These estimates may be based on a number of assumptions, including assumptions about prices and availability of labor, equipment and materials, and other issues. If these subcontractor quotations or cost estimates prove inaccurate, or if circumstances change, cost overruns may occur, and our financial results would be negatively impacted. In many cases, the incurrence of these additional costs would not be within our control.

We may have contracts in which we guarantee project completion by a scheduled date. At times, we may guarantee that the project, when completed, will achieve certain performance standards. If we fail to complete the project as scheduled, or if we fail to meet guaranteed performance standards, we may be held responsible for cost impacts and/or penalties to the customer resulting from any delay or for the costs to alter the project to achieve the performance standards. To the extent that these events occur and are not due to circumstances for which the customer accepts responsibility or cannot be mitigated by performance bonds or the provisions of our agreements with contractors, the total costs of the project would exceed our original estimates and our financial results would be negatively impacted.

Our customers may require us to secure performance and completion bonds for certain contracts and projects. The market environment for surety companies has become more risk averse. We secure performance and completion bonds for our contracts from these surety companies. To the extent we are unable to obtain bonds, we may not be awarded new contracts. We cannot assure you that we can secure performance and completion bonds when required.

Design, construction or system failures could result in injury to third parties or damage to property. Any losses that exceed claims against our contractors, the performance bonds and our insurance limits at such facilities could result in claims against us. In addition, if there is a customer dispute regarding performance of our services, the customer may decide to delay or withhold payment to us.

We have a limited number of employees and may not be able to manage the increasing demands of our expanding operations. We have a limited number of 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 and Chief Financial Officer. 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 for, among other things, regulatory penalties (including fines and suspension of operations), operational errors at the facilities, improper billing and collection processes, and loss of contracts and revenues. We cannot assure you that we can successfully manage our assets and our growth.

A failure of the water wells or distribution networks that we own or control could result in losses and damages that may affect our financial condition and reputation. We distribute water through a network of pipelines and store water in storage tanks and a pond. A failure of these pipelines, tanks or the pond could result in injuries and damage to property for which we may be responsible, in whole or in part. The failure of these pipelines, tanks, or pond may also result in the need to shut down some facilities or parts of our water distribution network in order to conduct repairs. Such failures and shutdowns may limit our ability to supply water in sufficient quantities to our customers and to meet the water delivery requirements prescribed by our contracts, which could adversely affect our financial condition, results of operations, cash flow, liquidity and reputation. Any business interruption or other losses might not be covered by insurance policies or be recoverable through rates and charges, and such losses may make it difficult for us to secure insurance in the future at acceptable rates.

Conflicts of interest may arise relating to the operation of the District. Our officers and employees constitute 50% of the directors of the District. Pure Cycle, along with our officers and employees and one unrelated individual, own the 40 acres that constitute the District. We have made loans to the District to fund its operations. At August 31, 2014, total principal and interest owed to us by the District was $568,000. Pursuant to our Service Agreement with the District for the provision of water services, the District retains two percent of the revenues from the sale of water to its end-use customers on the Lowry Range. Proceeds from the fee collections will initially be used to repay the District's obligations to us, but after these loans are repaid, the District is not required to use the funds to benefit Pure Cycle. We have received benefits from our activities undertaken in conjunction with the District, but conflicts may arise between our interests and those of the District, and with our officers who are acting in dual capacities in negotiating contracts to which both we and the District are parties. We expect that the District will expand when more properties are developed and become part of the District, and our officers acting as directors of the District will have fiduciary obligations to those other constituents. There can be no assurance that all conflicts will be resolved in the best interests of Pure Cycle and its shareholders. In addition, other landowners coming into the District will be eligible to vote and to serve as directors of the District. There can be no assurances that our officers and employees will remain as directors of the District or that the actions of a subsequently elected board would not have an adverse impact on our operations.

Our operations are affected by local politics and governmental procedures which are beyond our control. We operate in a highly political environment. We market our water rights to municipalities and other governmental entities run by elected or politically appointed officials. Our principal competitors are municipalities seeking to expand their sales tax base and other water districts. Various constituencies, including our competitors, developers, environmental groups, conservation groups, and agricultural interests, have competing agendas with respect to the development of water rights in Colorado, which means that decisions affecting our business are based on many factors other than economic and business considerations. Additional risks associated with dealing with governmental entities include turnover of elected and appointed officials, changes in policies from election to election, and a lack of institutional history in these entities concerning their prior courses of dealing with the Company. We spend significant time and resources educating elected officials, local authorities and others regarding our water rights and the benefits of contracting with us. Political concerns and governmental procedures and policies may hinder or delay our ability to enter into service agreements or develop our water rights or infrastructure to deliver our water. While we have worked to reduce the political risks in our business through our participation as the service provider for the District in regional cooperative resource programs, such as the SMWSA and its WISE partnership with Denver Water and Aurora Water, as well as education and communication efforts and community involvement, there can be no assurance that our efforts will be successful.

Our Lowry Range Surface water rights are “conditional decrees” and require findings of reasonable diligence. Our surface water interests and reservoir sites at the Lowry Range are conditionally decreed and are subject to a finding of reasonable diligence from the Colorado water court every six years. To arrive at a finding of reasonable diligence, the water court must determine that we continue to diligently pursue the development of said water rights. If the water court is unable to make such a finding, we could lose the water right under review. During fiscal 2012, the Lowry Range conditional decrees were granted their first review by the water court which determined that we and the District met the diligence criteria. The water court entered a finding of reasonable diligence on the Lowry Range surface water decrees on February 11, 2012. Our next diligence period will be in February 2018. If the water court does not make a determination of reasonable diligence in 2018, it would materially adversely impact the value of our interests in the Rangeview Surface Water Supply.

Water quality standards are subject to regulatory change. We must provide water that meets all federal and state regulatory water quality standards and operate our water and wastewater facilities in accordance with these standards. Future changes in regulations governing the supply of drinking water and treatment of wastewater may have a material adverse impact on our financial results. With respect to service of customers on the Lowry Range, the District’s rates might not be sufficient to cover the cost of compliance with additional or more stringent requirements. If the cost of compliance were to increase, we anticipate that the rates of the nearby water providers that the District uses to establish its rates and charges would increase to reflect these cost increases, thereby allowing the District to increase its rates and charges. However, there can be no assurance that these water providers would raise their rates in an amount that would be sufficient to enable the District (and us) to cover any increased compliance costs.

In October 2009, the Water Quality Control Division of the Colorado Department of Public Health and Environment advised us of proposed changes to the discharge permit for the District’s Coal Creek wastewater reclamation facility. The revised permit requires compliance with effluent ammonia limitations, use of E. coli rather than fecal coliform as an indicator of effluent disinfection efficacy, and a more stringent (lower) effluent chlorine residual limitation. The revised permit requires us to comply with the new criteria by October 2015. Although we anticipate being able to comply with the revised permit, there can be no assurances that we will be able to comply with future requirements or that the cost of such compliance will be covered by the rate structure required by the Rangeview Water Agreements.

Contamination to our water supply may result in disruption in our services and litigation, which could adversely affect our business, operating results and financial condition. Our water supplies are subject to contamination, including contamination from naturally occurring compounds, pollution from man-made sources and intentional sabotage. Our land at Sky Ranch and a portion of the Lowry Range have been leased for oil and gas exploration and development. Such exploration and development could expose us to additional contamination risks. In addition, we handle certain hazardous materials at our water treatment facilities, primarily sodium hypochlorite. Any failure of our operation of the facilities or any contamination of our supplies, including sewage spills, noncompliance with water quality standards, hazardous materials leaks and spills, and similar events could expose us to environmental liabilities, claims and litigation costs. If any of these events occur, we may have to interrupt the use of that water supply until we are able to substitute the supply from another source or treat the contaminated supply. We cannot assure you that we will successfully manage these issues, and failure to do so could have a material adverse effect on our future results of operations.

We may incur significant costs in order to treat the contaminated source through expansion of our current treatment facilities or development of new treatment methods. If we are unable to substitute water supply from an uncontaminated water source, or to adequately treat the contaminated water source in a cost-effective manner, there may be an adverse effect on our revenues, operating results and financial condition. The costs we incur to decontaminate a water source or an underground water system could be significant and could adversely affect our business, operating results and financial condition and may not be recoverable in rates.

We could also be held liable for consequences arising out of human exposure to hazardous substances in our water supplies or other environmental damage. For example, private plaintiffs could assert personal injury or other toxic tort claims arising from the presence of hazardous substances in our drinking water supplies. Although we have not been a party to any environmental or pollution-related lawsuits, such lawsuits have increased in frequency in recent years. If we are subject to an environmental or pollution-related lawsuit, we might incur significant legal costs, and it is uncertain whether we would be able to recover the legal costs from ratepayers or other third parties. Our insurance policies may not cover or provide sufficient coverage for the costs of these claims.

We may be adversely affected by any future decision by the Colorado Public Utilities Commission to regulate us as a public utility. The Colorado Public Utilities Commission (“CPUC”) regulates investor-owned water companies operating for the purpose of supplying water to the public. The CPUC regulates many aspects of public utilities’ operations, including establishing water rates and fees, initiating inspections, enforcement and compliance activities and assisting consumers with complaints. We do not believe we are a public utility under Colorado law. We currently provide services by contract mainly 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 were to occur, we might incur significant expense challenging the CPUC’s assertion of jurisdiction, and we may be unsuccessful. In the future, existing regulations may be revised or reinterpreted, and new laws and regulations may be adopted or become applicable to us or our facilities. If we become regulated as a public utility, our ability to generate profits could be limited and we might incur significant costs associated with regulatory compliance.

The District’s and our rights under the Lease have been challenged by third parties. The District’s and our rights under the Lease have been challenged by third parties, including the Land Board in the past. In 2014, in connection with settling a lawsuit filed by us and the District against the Land Board, the Land Board, the District and we amended and restated the Lease to clarify and update a number of provisions. However, there are issues still subject to negotiation and it is likely that during the remaining 67 year term of the Lease the parties will disagree over interpretations of provisions in the Lease again. There can be no assurance that the District’s or our rights under the Lease will not be challenged in the future, which could require potentially expensive litigation to enforce our rights.

We have incurred indebtedness to purchase promissory notes defaulted on by HP A&M which were secured by deeds of trust on our Arkansas River properties and water rights and if we are unable to pay that debt, we will lose some of our properties and the water rights associated with such properties. Approximately 60 of the 80 properties we acquired from HP A&M were subject to promissory notes owed by HP A&M to third parties with principal and accrued interest totaling $9.6 million at August 31, 2012. These promissory notes were secured by deeds of trust on our Arkansas River properties and water rights. HP A&M has defaulted on all of the notes. Although we are not legally responsible for paying these notes, if we did not cure the defaults, we would have lost 75% of the Arkansas River properties and a comparable percentage of the water rights. We foreclosed on the Pledged Shares, consisting of 1.5 million shares of our common stock owned by HP A&M which were pledged to us to secure the promissory notes. The foreclosure sale yielded $3.5 million which was not enough to cure all of the promissory notes. We have been acquiring the promissory notes to protect our Arkansas River properties. As of the filing date, we have successfully acquired all but one of the approximately $9.4 million of the notes payable by HP A&M in exchange for a combination of cash and secured notes. The notes we have issued are secured by the same Arkansas River properties and water rights and generally have a five-year term, bear interest at an annual rate of five percent and require semi-annual payments with a straight line amortization schedule. There can be no assurances that we will have sufficient resources in the future to pay all of the notes. If we were to default on our secured notes in the future, we could lose approximately 6,100 acres of our Arkansas River Properties and 6,700 FLCC shares. The loss of the Arkansas River properties and water rights could have a material adverse effect on our business, operating results and financial condition.

HP A&M attempted to acquire four of the Arkansas River properties, which were subject to promissory notes and deeds of trust defaulted on by HP A&M, without paying us for the properties. We have purchased all but one of the HP A&M notes and deeds of trust defaulted on by HP A&M and started foreclosure proceedings to clear title to the properties and obtain title to any mineral rights owned by HP A&M as additional collateral to recover the amounts we have had to pay to remedy HP A&M's defaults. HP A&M attempted to redeem four of the properties after the foreclosure sales were completed and sought a court order preventing the Public Trustee from issuing us the deeds to the properties as the successful bidder in the foreclosure sales. The court ruled against HP A&M on November 20, 2013. However, HP A&M has appealed the judgment. See "Item 3 – Legal Proceedings" for details regarding this lawsuit. If HP A&M's appeal is successful, we could lose these four properties, which have a market value of approximately $3,060,000. HP A&M would be liable to us for this loss pursuant to the terms of the Arkansas River Agreement, but there can be no assurance that we would recover such damages.

An unsuccessful resolution of our pending litigation against HP A&M seeking recovery for damages caused by its default on promissory notes secured by deeds of trust on our Arkansas River properties and water rights could materially adversely affect our financial condition and results of operations. We have purchased all but one of the HP A&M notes and deeds of trust defaulted on by HP A&M and have sued HP A&M for damages caused by its defaults. Additionally, pursuant to remedies outlined in our Agreement, we have foreclosed or have initiated foreclosure proceedings on 38 of the notes to clear title to the properties and obtain title to any mineral rights owned by HP A&M as a result of HP A&M's defaults. Further, we have reduced HP A&M's Tap Participation Fee pursuant to the Arkansas River Agreement. On April 4, 2014, we commenced a lawsuit against HP A&M seeking recovery for damages caused by its defaults of the Arkansas River Agreement and related agreements. HP A&M has asserted affirmative defenses, including breach of contract and breach of an implied covenant of good faith and fair dealing, and requested damages to be proven at trial. If we are unsuccessful in recovering our damages and related costs associated with HP A&M's default, or if HP A&M is successful in its counterclaims against us, it could have a material adverse effect on our financial condition and results of operations.

Our stock price has been volatile in the past and may decline in the future. Our common stock has experienced significant price and volume fluctuations in the past and may experience significant fluctuations in the future depending upon a number of factors, some of which are beyond our control. Factors that could affect our stock price and trading volume include, among others, the perceived prospects of our business; differences between anticipated and actual operating results; changes in analysts' recommendations or projections; the commencement and/or results of litigation and other legal proceedings; and future sales of our common stock by us or by significant shareholders, officers and directors. In addition, stock markets in general have experienced extreme price and volume volatility from time to time, which may adversely affect the market price of our common stock for reasons unrelated to our performance.

Item 1B – Unresolved Staff Comments

None.

Item 2 – Properties

Corporate Office – We occupy 1,200 square feet at a cost of $1,530, per month, at the address shown on the cover of this Form 10-K. We lease these premises pursuant to a two year operating lease agreement ending in December 2014 with a third party. We have plans in place for office space after December 2014.

Water Related Assets – In addition to the water rights and adjudicated reservoir sites which are described in Item 1 – Our Water Assets, we also own a 500,000 gallon water tank, 400,000 barrel storage reservoir, three deep water wells, a pump station, and several miles of water pipeline in Arapahoe County Colorado. Additionally, although owned by the District, we operate and maintain another 500,000 gallon water tank, two deep water wells, and pump station, three alluvial wells, the District’s wastewater treatment plant, and water distribution and wastewater collection pipelines that serve customers located at the Lowry Range. These assets are used to provide service to our existing customers.

Land – We own approximately 931 acres of land known as Sky Ranch which is described further in Item 1 – Our Water and Land Assets – Sky Ranch. In addition, we own approximately 14,900 acres of irrigated farm land in the Arkansas River Valley as described in Item 1 – Our Water and Land Assets – Arkansas River Water and Land. A portion of our farm land totaling 939 acres of land is currently held for sale. We also own 40 acres of land that comprise the current boundaries of the District.

Other Equipment – We also own various water delivery fixtures located on our farm properties. These items consist mainly of irrigation pumps, irrigation ditches, and irrigation pipelines.

Item 3 – Legal Proceedings

During the fiscal years ended August 31, 2014 and 2013, foreclosure proceedings were commenced against 38 of the properties we acquired from HP A&M, which are subject to promissory notes defaulted upon by HP A&M and secured by deeds of trust on our land and water rights. The proceedings were filed on various dates from January 9, 2013 through March 12, 2014, with the Public Trustees of Bent, Otero and Prowers Counties in Colorado and involve claims against HP A&M for its failure to pay the notes. In addition two proceedings were commenced against FLCC certificates pursuant to the Colorado Uniform Commercial Code (the “UCC”), representing water rights, one in 2013 and one on May 5, 2014. PCY Holdings, LLC (“PCY Holdings”), our wholly owned subsidiary, has been the successful bidder in foreclosure sales of all of the properties we acquired from HP A&M, including two completed after year end, and we terminated one foreclosure proceeding by curing HP A&M’s note. As of the date of this filing, one property remains subject to foreclosure proceedings. This property represent less than 3% of our FLCC shares and less than 2% of our farm land acquired from HP A&M.

Foreclosure sales were conducted on three of our properties on August 28, 2013, and on a fourth property on September 4, 2013. PCY Holdings was the successful bidder in these foreclosure sales. On September 16, 2013, HP A&M filed a complaint against PCY Holdings and the Public Trustee for the County of Bent, Colorado, in the District Court, County of Bent, Colorado. HP A&M sought (i) a declaratory judgment that it is entitled to redeem the four properties from the foreclosure sales by paying the amount of the outstanding debt, plus fees, which is the amount we bid in the sales, and (ii) preliminary and permanent injunctions against the Public Trustee preventing the Public Trustee from issuing confirmation deeds for the foreclosure sales to PCY Holdings or anyone other than HP A&M. On November 20, 2013, the complaint was dismissed with prejudice, and judgment was entered in favor of the Public Trustee and PCY Holdings. The Public Trustee issued the confirmation deeds to PCY Holdings on December 5, 2013. The District Court also awarded the Public Trustee of Bent County and PCY Holdings their attorneys’ fees and costs incurred in connection with this matter. In subsequent proceedings regarding a petition filed by PCY Holdings with the District Court requesting the removal of lis pendens filed against the four properties by HP A&M, the District Court awarded attorneys’ fees to HP A&M with respect to the petition. Responses to motions by both PCY Holdings and HP A&M regarding the attorneys’ fee awards have been stayed pending the outcome of the appeal, discussed below, of the District Court’s initial ruling against HP A&M.

On January 3, 2014, HP A&M filed a notice of appeal of the judgment with the Colorado Court of Appeals. If HP A&M wins on appeal, we could lose these four properties, subject to our remedies under the Arkansas River Agreement. We intend to vigorously defend the appeal of this ruling. The Arkansas River agreement requires HP A&M to acquire any properties subject to foreclosure on our behalf. Therefore, our remedies against HP A&M for the note defaults include the right to damages for any loss of these four properties.

We filed a lawsuit against HP A&M in the District Court, City and County of Denver, State of Colorado on April 4, 2014, alleging HP A&M breached the Arkansas River Agreement, Seller Pledge Agreement and Property Management Agreement, among other ways, by failing to (i) pay, perform and discharge its obligations when due or otherwise pursuant to the Excluded Indebtedness, (ii) cure defaults under the notes and deeds of trust representing the Excluded Indebtedness, and (iii) use Net Revenue, pursuant to the Property Management Agreement, to pay Excluded

Indebtedness. As a result of these breaches, we are claiming damages to be proven at trial, and estimated as of the date of the lawsuit to be not less than $8 million. HP A&M filed its answer on May 30, 2014, asserting affirmative defenses and counterclaims, including, among others, breach of contract and breach of implied covenant of good faith and fair dealing and requesting damages in an amount to be proven at trial.

On July 10, 2014, we, the District and the Land Board, entered into a settlement agreement with respect to the lawsuit filed in December 2011 by us and the District against the Land Board involving certain claims arising out of or related to (i) the 1996 Amended and Restated Lease Agreement and (ii) the 1996 Service Agreement. The settlement agreement also settles certain claims related to operational issues under the Lease which the parties had previously agreed to submit to arbitration. Pursuant to the settlement, we, the District, and the Land Board entered into the 2014 Amended and Restated Lease Agreement. In addition, we and the District entered into the 2014 Amended and Restated Service Agreement. In conjunction with the settlement, the Land Board assigned us its right to receive approximately $2.4 million from future sales of Export Water under the CAA. For a more detailed discussion of the terms of the settlement, see the Current Report on Form 8-K filed on July 14, 2014.

On September 29, 2014, we reached a settlement agreement with HP A&M. The agreement settles a lawsuit filed in 2012 by HP A&M against us involving certain claims arising out of or related to the 1996 Amended and Restated Lease Agreement. We and HP A&M have agreed to dismiss all claims relating to the 2012 lawsuit with prejudice.

Item 4 – Mine Safety Disclosures

None.

PART II

Item 5 – Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) Market Information

Our common stock is traded on the NASDAQ Capital Market under the symbol "PCYO". The high and low sales prices of our common stock, by quarter, for the fiscal years ended August 31, 2014 and 2013 are presented below:

Fiscal 2014 quarters ended:	August 31	May 31	February 28	November 30
Market price of common stock				
High	$7.36	$7.00	$7.19	$7.19
Low	$5.40	$4.96	$5.62	$4.34

Fiscal 2013 quarters ended:	August 31	May 31	February 28	November 30
Market price of common stock				
High	$6.72	$7.32	$4.10	$2.78
Low	$5.00	$3.87	$2.31	$1.87

(b) Holders

On November 10, 2014, there were 1,029 holders of record of our common stock.

(c) Dividends

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

(d) Securities Authorized For Issuance Under Equity Compensation Plans

Table D - Securities Authorized for Issuance Under Equity Compensation Plans

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation

	and rights		plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans:			
Approved by security holders	315,000	$ 5.76	1,600,000
Not approved by security holders	–	–	–
Total	315,000	$ 5.76	1,600,000

e) Performance Graph 1

This graph compares the cumulative total return of our common stock for the last five fiscal years with the cumulative total return for the same period of the S&P 500 Index and a peer group index2. The graph assumes the investment of $100 in common stock in each of the indices as of the market close on August 31 and reinvestment of all dividends.

	2014	2013	2012	2011	2010
Pure Cycle Corporation	$200.62	$160.00	$61.54	$91.08	$92.62
S&P 500	$218.10	$174.13	$146.70	$124.32	$104.91
Peer Group	$191.82	$172.75	$144.09	$126.56	$112.06

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1. This performance graph is not “soliciting material,” is not deemed “filed” with the Commission and is not to be incorporated by reference in any of our filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.

2. The Peer Group consists of the following companies that have been selected on the basis of industry focus or industry leadership: American States Water Company, Aqua America, Inc., Artesian Resources Corp., California Water Service Group, Connecticut Water Service, Inc., Middlesex Water Company, Pennichuck Corp., SJW Corp., and The York Water Company.

(f) Recent Sales of Unregistered Securities; Use of Proceeds From Registered Securities

None.

(g) Purchase of Equity Securities By the Issuer and Affiliated Purchasers

None.

Item 6 – Selected Financial Data

Table E - Selected Financial Data

In thousands (except per share data)	For the Fiscal Years Ended August 31,				
	2014	2013	2012	2011	2010
Summary Statement of Operations items:					
Total revenues	$3,091.1	$1,857.5	$284.4	$282.1	$264.1
Net loss	$(311.4)	$(4,150.4)	$(17,418.7)	$(6,016.2)	$(5,391.3)
Basic and diluted loss per share	$(0.01)	$(0.17)	$(0.72)	$(0.26)	$(0.27)
Weighted average shares outstanding	24,038	24,038	24,038	23,169	20,207
	As of August 31,				
Summary Balance Sheet Information:	2014	2013	2012	2011	2010
Current assets	$4,463.3	$9,900.0	$7,661.8	$5,065.6	$1,819.6
Total assets	$108,173.8	$108,618.3	$111,582.0	$116,122.7	$106,377.8
Current liabilities	$3,274.4	$5,402.3	$6,254.8	$658.3	$171.3
Long term liabilities	$13,868.9	$65,443.5	$75,209.5	$68,174.0	$63,746.5
Total liabilities	$17,143.3	$70,845.8	$81,464.3	$68,832.3	$63,917.8
Equity	$91,030.5	$37,772.5	$30,117.8	$47,290.3	$42,460.0

The following items had a significant impact on our operations:

- In fiscal 2014 in order to protect our farm assets we acquired the remaining approximately $2.6 million of the $9.6 million in HP A&M defaulted notes. Additionally, we borrowed $1.75 million, sold farms for $5.8 million, and invested $3.7 million in our water systems. Subsequent to fiscal year end, we refinanced approximately $1.8 million of the notes we had issued to purchase the notes and deeds of trust defaulted on by HP A&M and we obtained an additional $1.0 million for working capital. Additionally, we recorded an impairment of approximately $400,000 on land and water rights held for sale and we recorded a gain of $1.3 million upon completing the sale of certain farms that we previously impaired in fiscal 2012. See further discussion in Note 4 – Water and Land Assets in the accompanying financial statements.

- In fiscal 2013, in order to protect our farm assets, we acquired approximately $7 million of the $9.6 million in HP A&M notes. Additionally we sold 1,500,000 unregistered shares of Pure Cycle common stock owned by HP A&M for $2.35 per share, yielding approximately $3.4 million, net of expenses.

- In fiscal 2012 the Paradise Water Supply asset was deemed fully impaired and the entire asset value of $5.5 million was written off and recorded in the accompanying financial statements. Additionally, we recorded an impairment of $6.5 million on land and water rights held for sale. See further discussion in Note 4 – Water and Land Assets in the accompanying financial statements.

- In fiscal 2014, 2013, 2012, 2011 and 2010, respectively, we imputed $1.4 million, $3.3 million, $3.5 million, $3.8 million, and $3.6 million of interest related to the Tap Participation Fee payable to HP A&M. As described below, this represents the difference between the net present value and the estimated realizable value of the Tap Participation Fee, which is being charged to expense using the effective interest method over the estimated development period utilized in the valuation of the Tap Participation Fee. The Tap Participation Fee is payable when we sell water taps and receive funds from such water tap sales or other dispositions of property purchased from HP A&M.

- In fiscal 2011, we acquired approximately 931 acres of land known as Sky Ranch for $7.0 million.

- In fiscal 2010, we sold a total of 3.8 million shares of common stock for a total of $10.7 million, which was used to acquire the Sky Ranch property and for working capital.

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

Overview

The discussion and analysis below includes certain forward-looking statements that are subject to risks, uncertainties and other factors, as described in "Risk Factors" and elsewhere in this Annual Report on Form 10-K, that could cause our actual growth, results of operations, performance, financial position and business prospects and opportunities for this fiscal year and the periods that follow to differ materially from those expressed in, or implied by, those forward-looking statements. Readers are cautioned that forward-looking statements contained in this Form 10-K should be read in conjunction with our disclosure under the heading: "SAFE HARBOR STATEMENT UNDER THE UNITED STATES PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995" on page 4.

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

- Revenue generated from providing water and wastewater services and our farming operations;
- Expenses associated with developing our water and land assets; and
- Cash available to continue development of our water rights and service agreements.

Our MD&A section includes the following items:

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

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

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

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

Our Business

Pure Cycle Corporation ("we", "us" or "our") is an investor-owned Colorado corporation that (i) provides wholesale water and wastewater services to end-use customers of governmental entities and to commercial and industrial customers and (ii) manages land and water assets for farming.

Wholesale Water and Wastewater

These services include water production, storage, treatment, bulk transmission to retail distribution systems, wastewater collection and treatment, irrigation water treatment and transmission, construction management, billing and collection and emergency response.

We are a vertically integrated wholesale water and wastewater provider, which means we own or control substantially all assets necessary to provide wholesale water and wastewater services to our customers. This includes owning (i) water rights which we use to provide domestic, irrigation, and industrial water to our wholesale customers (we own surface water, groundwater, reclaimed water rights and storage rights), (ii) infrastructure (such as wells, diversion structures, pipelines, reservoirs and treatment facilities) required to withdraw, treat, store and deliver water, (iii) infrastructure required to collect, treat, store and reuse wastewater, and (iv) infrastructure required to treat and deliver reclaimed water for irrigation use.

We currently provide wholesale water and wastewater service predominately to two local governmental entity customers. Our largest wholesale domestic customer is the District. We provide service to the District and its end-use customers pursuant to the Rangeview Water Agreements between us and the District for the provision of wholesale water service to the District for use in the District's service area. Through the District, we serve 258 SFE water connections and 157 SFE wastewater connections located in southeastern metropolitan Denver. In the past two years, we have been providing an increasing amount of water to industrial customers in our service area and adjacent to our service ares to the oil and gas industry for the purposes of hydrologic fracturing. Oil & gas operators have leased more than 135,000 acres within and adjacent to our service areas for the purpose of exploring oil and gas interest in the Niobrara and other formations and this activity has led to increased water demands.

We plan to utilize our significant water assets along with our adjudicated reservoir sites to provide wholesale water and wastewater services to local governmental entities which in turn will provide residential/commercial water and wastewater services to communities along the eastern slope of Colorado in the area generally referred to as the Front Range. Principally we target 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. We also plan to continue to provide water service to commercial and industrial customers.

Agricultural Operations and Leasing

Based on total acreage, approximately 85% of our farm operations are managed through cash lease arrangements with local area farmers whereby we charge a fixed fee to lease our land and the water for agricultural purposes to tenant farmers. Based on total acreage, approximately 15% of our farm operations are managed through crop share leases, pursuant to which we and the tenant farmer jointly share in the gross revenues generated from the crops grown under a 75% farmer, 25% landlord participation. The majority of crops grown on our farms are alfalfa, with a number of acres also planted in corn, sorghum, and wheat. We will continue to review and evaluate ways to enhance the performance of our approximately 14,900 acres of farm land through relationships with area farmers.

We also own 931 acres of land along the I-70 corridor east of Denver, Colorado. We are currently leasing this land to an area farmer until such time as the property can be developed.

These land interests are described in the Arkansas River Assets and Sky Ranch sections of Note 4 - Water and Land Assets to the accompanying financial statements.

Critical Accounting Policies and Use of Estimates

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

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

Revenue Recognition

Our revenues consist mainly of monthly service fees, tap fees, construction fees, and beginning in fiscal 2013, farm operations. As further described in Note 2 – Summary of Significant Accounting Policies to the accompanying financial statements, proceeds from tap sales and construction fees are deferred upon receipt and recognized in income based on whether we own or do not own the facilities constructed with the proceeds. We recognize tap fees derived from agreements for which we construct infrastructure owned by others as revenue, along with the associated costs of construction, pursuant to the percentage-of-completion method. The percentage-of-completion method requires management to estimate the percent of work that is completed on a particular project, which could change materially throughout the duration of the construction period and result in significant fluctuations in revenue recognized during the reporting periods throughout the construction process. We did not recognize any revenues pursuant to the percentage-of-completion method during the fiscal years ended August 31, 2014, 2013 or 2012.

Tap and construction fees derived from agreements for which we own the infrastructure are recognized as revenue ratably over the estimated service life of the assets constructed with said fees. Although the cash will be received up-front and most construction will be completed within one year of receipt of the proceeds, revenue recognition may occur over 30 years or more. Management is required to estimate the service life, and currently the service life is based on the estimated useful accounting life of the assets constructed with the tap fees. The useful accounting life of the asset is based on management's estimation of an accounting based useful life and may not have any correlation to the actual life of the asset or the actual service life of the tap. This is deemed a reasonable recognition life of the revenues because the depreciation of the assets constructed generating those revenues will therefore be matched with the revenues.

Monthly water usage fees and monthly wastewater service fees are recognized in income each month as earned.

Pursuant to the O&G Lease and an oil and gas on 40 acres of mineral estate the Company owns adjacent to the Lowry Range (the "Rangeview Lease"), we received up-front payments which are recognized as other income on a straight-line basis over the initial term or extension of term, as applicable, of the leases.

Currently we lease our farms to local area farmers on both cash and crop share lease basis. Our cash lease farmers are charged a fixed fee, which is billed semi-annually in March and November. During the November billing cycle our cash lease billings include either a discount or a premium adjustment based on actual water deliveries by the FLCC. Our crop share lease fees are based on actual crop yields and are received upon the sale of the crops. All fees are estimated and recognized ratably on a monthly basis.

Impairment of Water Assets and Other Long-Lived Assets

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

Our water assets will be utilized in the provision of water services which inevitably will encompass many housing and economic cycles. Our service capacities are quantitatively estimated based on an average single family home consuming approximately .2 acre feet of water per year. Average water deliveries are approximately .4 acre feet, however approximately 50% or .2 acre feet are returned and available for reuse. Our water supplies are legally decreed to us through the water court. The water court decree allocates a specific amount of water (subject to continued beneficial use) which historically has not changed. Thus, individual housing and economic cycles typically do not have an impact on the number of connections we can serve with our supplies or the amount of water legally decreed to us relating to these supplies.

We report assets to be disposed of at the lower of the carrying amount or fair value less costs to sell.

Our Front Range and Arkansas River Water Rights – We determine the undiscounted cash flows for our Denver based assets and the Arkansas River assets by estimating tap sales to potential new developments in our service area and along the Front Range, using estimated future tap fees less estimated costs to provide water services, over an estimated development period. Actual new home development in our service area and the Front Range, actual future tap fees, and actual future operating costs, inevitably will vary significantly from our estimates, which could have a material impact on our financial statements as well as our results of operations. We performed an impairment analysis as of August 31, 2014, and determined there were no material changes and that our Denver based assets and our Arkansas River assets are not impaired and their costs are deemed recoverable. Our impairment analysis is based on development occurring within areas in which we have service agreements (e.g. Sky Ranch and the Lowry Range) as well as in surrounding areas, including the Front Range and the I-70 corridor. Our combined Rangeview Water Supply, Sky Ranch water and Arkansas River water assets which have a carrying value of $90.8 million as of August 31, 2014. Based on the carrying value of our water rights, the long term and uncertain nature of any development plans, current tap fees of $24,620 and estimated gross margins, we estimate that we would need to add 7,600 new water connections (requiring 5.7% of our portfolio) to generate net revenues sufficient to recover the costs of our Rangeview Water Supply and Arkansas River water assets. If tap fees increase 5%, we would need to add 7,200 new water taps (requiring 5.4% of our portfolio) to recover the costs of our Rangeview Water Supply and Arkansas River water assets. If tap fees decrease 5%, we would need to add 8,000 new water taps (requiring 5.9% of our portfolio) to recover the costs of our Rangeview Water Supply and Arkansas River water assets.

Although changes in the housing market throughout the Front Range have delayed our estimated tap sale projections, these changes do not alter our water ownership, nor our service obligations to existing properties or the number of SFE's we can service.

We have contracts to sell a farm totaling 299 acres along with 239 FLCC shares associated with the land. Management has also decided it would be in the best interest of the Company to identify approximately 640 acres of land along with approximately 512 FLCC shares, but has not yet identified farms or entered into any agreements to sell farms. We have impaired these farms and recorded them as land and water held for sale.

Our Paradise Water Supply – We have deemed the Paradise Water Supply to be fully impaired and an impairment of $5.5 million was recorded in the fiscal 2012 financial statements. The Paradise Water Supply asset was conveyed to a third party nonprofit corporation and is no longer owned by us as of August 31, 2014.

Tap Participation Fee

The $7.9 million TPF liability at August 31, 2014, represents the estimated discounted fair value of our obligation to pay HP A&M 20% of the our gross proceeds, or the equivalent thereof, from the sale of the next 2,184 water taps sold by us.

As partial consideration for the purchase of our farms and related water, we agreed to pay HP A&M 10% of the tap fees we receive from the next 40,000 water taps we sell from and after the date of the Arkansas River Agreement. The TPF is payable only when we sell water taps from any of our water assets or when we sell any of the water rights we purchased from HP A&M, in either case only once we receive funds from such sale. Payment of the TPF may be accelerated in the event of a merger, reorganization, sale of substantially all assets, or similar transactions and in the event of bankruptcy and insolvency events. The TPF liability is valued by estimating new home development in our service area over an estimated development period. This was done by utilizing third party historical and projected housing and population growth data for the Denver metropolitan area applied to an estimated development pattern supported by historical development patterns of certain master planned communities in the Denver metropolitan area. This development pattern was then applied to projected future water tap fees determined by using historical water tap fee trends. Actual new home development in our service area and actual future tap fees inevitably will vary significantly from our estimates, which could have a material impact on our financial statements as well as our results of operations. The difference between the net present value and the estimated realizable value will be imputed as interest expense using the effective interest method over the estimated development period utilized in the valuation of the TPF. See further discussion in the "Obligations Payable by HP A&M, Now in Default" section below.

A component in our estimate of the value of the TPF is that water tap fees may continue to increase in the coming years. Tap fees are market based and increases in tap fees reflect, among other things, the increasing costs to acquire and develop new water supplies. Tap fees thus are partially indicative of the increasing value of our water assets. We continue to assess the value of the TPF liability and update our valuation analysis whenever events or circumstances indicate the assumptions used to estimate the value of the liability have changed materially. We updated the estimated discounted cash flow analysis as of August 31, 2014, as described in more detail below.

Pursuant to the Arkansas River Agreement, effective as of September 1, 2011, HP A&M elected to increase the TPF percentage from 10% to 20% and take a corresponding 50% reduction in the number of taps subject to the TPF. In addition, the initial term of the Property Management Agreement with HP A&M expired on August 31, 2011. During the extended term of the Property Management Agreement, we were permitted to allocate 26.9% of the Net Revenues (defined as all lease and related income received from the farms less employee expenses, direct expenses for managing the leases and a reasonable overhead allocation) paid to HP A&M against the TPF. As a result of HP A&M's default, on August 3, 2012 we terminated the Property Management Agreement and stopped allocating 26.9% of the Net Revenues to the TPF.

During the 2013 fiscal year we foreclosed on three farms and one FLCC certificate representing water rights only. Additionally we withdrew one farm from foreclosure. As a result of these foreclosures, in accordance with our remedies pursuant to our agreement with HP A&M, we exercised our right to reduce the TPF. We reduced the number of taps subject to the TPF by 2,233 taps, and the discounted present value of the TPF by a total of approximately $11.7 million.

During the 2014 fiscal year we foreclosed on 31 farms and two FLCC certificates representing water rights only. As a result of these foreclosures, in accordance with our remedies pursuant to our agreement with HP A&M we exercised our right to reduce the TPF. We reduced the number of taps subject to the TPF by 15,113 taps, and the discounted present value of the TPF by a total of approximately $53.6 million.

As a result of the events described above, we revalued the TPF liability as of August 31, 2014. The updated valuation and the events described above resulted in the following:

- Our obligation to pay HP A&M 20% of the gross proceeds, or the equivalent thereof, from the sale of the next 19,468 water taps as of September 1, 2011, became an obligation to pay 20% of the gross proceeds, or the equivalent thereof, from the sale of the next 2,184 water taps.

- The total undiscounted estimated payments to HP A&M for the TPF decreased $53.3 million from the previous valuation completed in fiscal 2013. The total estimated payments were then discounted to the current valuation date and the difference between the amount reflected on the Company's balance sheet and the total estimated payments is imputed as interest expense over the estimated development life using the effective interest method. The imputed effective interest rate remained 6.6% and the amount of interest imputed was $1.4 million for fiscal 2014.

As of August 31, 2014 there were 2,184 taps subject to the TPF and we revalued the TPF liability resulting in a remaining discounted present value liability of $7.9 million. $27.5 million of interest has been imputed since the acquisition date recorded using the effective interest method. Subsequent to August 31, 2014, an additional 981 FLCC shares, were foreclosed resulting in a reduction of the number of taps subject to the TPF by an additional 1,801 taps (approximately $6.2 million of the TPF), leaving 383 taps (approximately $1.7 million) subject to the TPF.

Fair Value Estimates

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market. We generally use a fair value hierarchy that has three levels of inputs, both observable and unobservable, with use of the lowest possible level of input to determine fair value. See Note 3 – Fair Value Measurements to the accompanying financial statements. As discussed below, we used other methodologies to determine the fair value of the related party receivable from HP A&M, certain notes payable issued by us in exchange for HP A&M notes, and the receivable for unpaid balances owed to HP A&M for farm lease payments that are now payable to us.

Obligations Payable by HP A&M, Now in Default – Approximately 60 of the 80 properties we acquired from HP A&M were subject to outstanding promissory notes payable to third parties. These promissory notes are secured by deeds of trust on our properties and water rights, as well as mineral interests, up to 25% of which are owned by us and up to 75% of which are currently owned by HP A&M. As of fiscal year end 2012 and since that date, HP A&M has defaulted on all of the notes. At the time of default, HP A&M owed approximately $9.6 million of principal and accrued interest secured by approximately 14,000 acres of farm land and 16,882 FLCC shares representing water rights owned by us.

On July 2, 2012, we formally notified HP A&M that its failure to pay the promissory notes constituted an Event of Default under the Seller Pledge Agreement and a default of a material covenant under the Arkansas River Agreement and that unless such defaults were cured within 30 days, the Property Management Agreement would be terminated and we would proceed to exercise certain rights and remedies under the Arkansas River Agreement, the Seller Pledge Agreement, and the Property Management Agreement to protect our assets. Our remedies at law and under the Arkansas River Agreement and related agreements include, but are not limited to, the right to (i) terminate the Property Management Agreement; (ii) foreclose on the Pledged Shares; (iii) reduce the Tap Participation Fee; and (iv) recover damages caused by the defaults, including certain costs and attorneys' fees. Pursuant to these remedies we have taken the following actions:

(i) On August 3, 2012, we formally terminated the Property Management Agreement. See further discussion in Farm Accounts Receivable and Future Farm Income below.

(ii) During September 2012 we sold the Pledged Shares in accordance with the Seller Pledge Agreement yielding approximately $3.4 million to us.

(iii) As described in Note 7 – Long Term Debt and Operating Lease, to the accompanying consolidated financial statements, to protect our land and water interests, upon a default by HP A&M, at our sole discretion, we may take any measure we deem appropriate to remedy all of the defaults. If we did not protect our interest relating to the defaults, we could have lost the properties and water rights securing the defaulted notes. As of August 31, 2014, we have acquired approximately $9.4 million of the $9.6 million of promissory notes that are payable by HP A&M to third parties. These promissory notes were acquired with cash payments of approximately $2.4 million and the issuance of notes by us. The majority of the notes we issued have a five-year term, bear interest at an annual rate of five percent and require semi-annual payments with a straight-line amortization schedule. The carrying value of the notes payable approximate the fair value as the rates are comparable to market rates.

During the 2013 and 2014 fiscal years 35 farms and three FLCC certificate representing water only went through foreclosure proceedings. In accordance with our remedies pursuant to our agreement with HP A&M, we exercised our right to reduce the TPF as a result of these foreclosures. Through August 31, 2014 we have reduced the number of taps by 17,243 or a total of approximately $65.1 million. Subsequent to our fiscal year end an additional two farms and 981 FLCC shares have been through foreclosure proceedings resulting in a further reduction of 1,801 taps. As of the date of this filing 383 taps remain subject to the TPF.

(iv) We have the right to collect from HP A&M any amounts we spend to protect our interest against the defaulted notes, including the new notes we issue to the holders in exchange for the HP A&M notes. Among other remedies we have the right to collect from HP A&M all costs and expenses, including reasonable attorneys' fees, we incur to protect our interest against the defaults and in protecting our rights and title to the farm property and water rights securing the notes. See Note 12 – Litigation Loss Contingencies. The following table details the balance in HP default receivable as of August 31, 2014 and August 31, 2013.

	August 31, 2014	August 31, 2013
HP A&M receivable		
Mortgage default (1)	$9,643,550	$9,643,550
Attorneys' fees, filing fees, & other costs (2)	840,961	426,606
	10,484,511	10,070,156
Pledged share sale	(3,415,000)	(3,415,000)
HP A&M receivable	$7,069,511	$6,655,156

1) Includes default interest paid at the time we acquired the notes. In addition to the interest included above interest continues to accrue at a default interest rate of 10% per annum. As of August 31, 2014 the balance of default interest not accrued above was approximately $1,553,900. Payment of the default interest remains the sole responsibility of HP A&M.
2) In addition to the above we expensed $72,557 in attorney's fees related to the defaults through 2014 that have not been accrued.

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Farm Accounts Receivable and Farm Operations – Most of the farm leases are cash only leases and a few are crop share leases. A “crop share” lease entitles us to a share of the sales from the crop sales of the farmer. Most of the farm leases expire on December 31, 2014 and are expected to be renewed for an additional three-year term, while the remaining leases have a variety of expiration dates. The cash only lease payments are generally billed twice a year in March and November. The unpaid balances from the March billing were recorded on our books as accounts receivable (less an allowance for uncollectible accounts) of $56,500. Most of our leases expire on December 31, 2014. We are in the process of negotiating renewals of the leases and expect we will be able to renew most of the leases prior December 31, 2014. Under the cash only lease agreements, the annual lease payment can be reduced if the number of annual runs of irrigation water delivered to the farm as reported by the Fort Lyon Canal Company fall below 20 runs. If the annual runs of irrigation are less than 20, the annual lease rate will be reduced by $2 per acre per run less than the 20 runs with a maximum annual discount of $10 per acre. During calendar year 2014, the lessee farmers received more than 20 runs through September 30, 2014. Accordingly, no discount or premium will be applied to the second billing in November 2014. All future expected cash billings are reflected at their full value. The crop share agreements are generally 1 year agreements and the payment cannot be calculated until after the farmers sell their crops. Accordingly any future payments from crop share leases are not included in the future farm lease billings schedule below.

The future scheduled billing for the farm income is presented in Table F below:

Table F - Contractual Farm lease income receivable

		Payments due to Pure Cycle by period	
	Total	Less than 1 year	1-3 years
Contractual lease income receivable			
Farm leases receivable	$512,900	$512,900	$-
Total	$512,900	$512,900	$-

Expenses associated with the farm operations include management salaries, maintenance, property taxes and FLCC assessments.

Share-based compensation

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

Results of operations

Executive Summary

The results of our operations for the fiscal years ended August 31, 2014, 2013 and 2012 were as follows:

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Table G - Summary Results of Operations

	Fiscal Years Ended August 31,			Change 2014-2013		Change 2013-2012	
	2014	2013	2012	$	%	$	%
Millions of gallons of water delivered	190.1	69.2	34.2	120.9	175 %	35.0	102 %
Water revenues generated	$1,879,500	$502,700	$182,800	$1,376,800	274 %	$319,900	175 %
Water delivery operating costs incurred (excluding depreciation and depletion)	$547,600	$188,300	$78,100	$359,300	191 %	$110,200	141 %
Water delivery gross margin %	71 %	63 %	57 %				
Wastewater treatment revenues	$45,400	$41,700	$45,800	$3,700	9 %	$(4,100)	-9 %
Wastewater treatment operating costs incurred	$38,400	$17,000	$19,300	$21,400	126 %	$(2,300)	-12 %
Wastewater treatment gross margin %	15 %	59 %	58 %				
Farm operations	$1,068,000	$1,241,900	$-	$(173,900)	-14 %	$1,241,900	0 %
Farm operations operating costs incurred	$88,100	$96,300	$-	$(8,200)	-9 %	$96,300	0 %
Farm operations gross margin %	92 %	92 %					
General and administrative expenses	$3,356,900	$2,333,100	$2,374,100	$1,023,800	44 %	$(41,000)	-2 %
Net losses	$311,400	$4,150,400	$17,418,700	$(2,933,200)	-71 %	$(13,268,300)	-76 %

Changes in Revenues

We generate revenues from (i) one time water and wastewater tap fees, (ii) construction fees, (iii) monthly wholesale water usage fees and wastewater service fees and (iv) farm operations.

Water and Wastewater Revenues – Our water deliveries increased 175% in fiscal 2014 compared to fiscal 2013 and 102% in fiscal 2013 compared to fiscal 2012. Water revenues increased 274% in fiscal 2014 compared to fiscal 2013 and 175% in fiscal 2013 compared to fiscal 2012. Both deliveries and sales increased primarily as a result of the addition of water sales used for oil and gas activities, which was used to frack wells drilled into the Niobrara formation. The following table details the sources of our sales, the number of kgal (1,000 gallons) sold, and the average price per kgal for fiscal 2014, fiscal 2013, and fiscal 2012.

Water Revenue Summary

	2014		2013	2012
Customer Type	Sales (in thousands)	kgal		