PURE CYCLE CORP
Form 10-Q
July 06, 2016

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

Form 10-Q

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

For the quarterly period ended: May 31, 2016
or
__ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to __________

Commission file number 0-8814

PURE CYCLE CORPORATION

(Exact name of registrant as specified in its charter)

Colorado	84-0705083
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
34501 E. Quincy Avenue, Bldg. 34, Box 10, Watkins, CO (Address of principal executive offices)	80137 (Zip Code)

(303) 292 – 3456
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 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 Exchange Act).
Yes [ ] No [X]
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of July 6, 2016:

Common stock, 1/3 of $.01 par value	23,754,098
(Clas	(Number of Shares)

PURE CYCLE CORPORATION
INDEX TO MAY 31, 2016 FORM 10-Q

PART I – FINANCIAL INFORMATION
Item 1. Consolidated Financial Statements
PURE CYCLE CORPORATION
CONSOLIDATED BALANCE SHEETS

ASSETS:	May 31, 2016	August 31, 2015
Current assets:	(unaudited)	
Cash and cash equivalents	$5,114,663	$37,089,041
Short-term investments	23,148,458	-
Trade accounts receivable	151,194	399,925
Sky Ranch receivable	-	148,415
Prepaid expenses	373,912	228,086
Assets of discontinued operations	801,565	1,715,472
Total current assets	29,589,792	39,580,939
Long-term investments	7,034,100	-
Investments in water and water systems, net	27,969,211	27,708,595
Land and mineral interests	5,271,313	5,091,668
Notes receivable - related parties, including accrued interest	788,624	591,223
Other assets	470,218	88,488
Total assets	$71,123,258	$73,060,913
LIABILITIES:		
Current liabilities:		
Accounts payable	$99,731	$172,634
Accrued liabilities	86,542	499,808
Income taxes	-	292,729
Deferred revenues	55,800	55,800
Deferred oil and gas lease payment	24,000	360,765
Liabilities of discontinued operations	3,602	117,329
Total current liabilities	269,675	1,499,065
Deferred revenues, less current portion	1,069,441	1,111,293
Deferred oil and gas lease payment, less current portion	1,000	19,000
Participating Interests in Export Water Supply	344,378	346,007
Total liabilities	1,684,494	2,975,365
Commitments and contingencies		
SHAREHOLDERS' EQUITY:		
Preferred stock:		
Series B - par value $.001 per share, 25 million shares authorized; 432,513 shares issued and outstanding (liquidation preference of $432,513)	433	433
Common stock:		

Par value 1/3 of $.01 per share, 40 million shares authorized;		
23,754,098 and 24,054,098 shares outstanding, respectively	79,185	80,185
Collateral stock	-	(1,407,000)
Additional paid-in capital	171,145,416	172,384,355
Accumulated other comprehensive income (loss)	(23,335)	-
Accumulated deficit	(101,762,935)	(100,972,425)
Total shareholders' equity	69,438,764	70,085,548
Total liabilities and shareholders’ equity	$71,123,258	$73,060,913

See accompanying Notes to Consolidated Financial Statements

1

PURE CYCLE CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(unaudited)

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2016	2015	2016	2015
Revenues:				
Metered water usage	$35,659	$73,477	$119,832	$893,746
Wastewater treatment fees	10,537	12,293	31,540	37,224
Special facility funding recognized	10,377	10,377	31,131	31,131
Water tap fees recognized	3,574	3,574	10,721	10,721
Other	40,705	20,639	109,980	89,490
Total revenues	100,852	120,360	303,204	1,062,312
Expenses:				
Water service operations	(65,184)	(73,679)	(190,976)	(303,110)
Wastewater service operations	(7,286)	(9,265)	(20,555)	(22,075)
Depletion and depreciation	(41,604)	(42,072)	(124,834)	(130,802)
Other	(20,763)	(14,746)	(51,373)	(35,771)
Total cost of revenues	(134,837)	(139,762)	(387,738)	(491,758)
Gross (loss) profit	(33,985)	(19,402)	(84,534)	570,554
General and administrative expenses	(431,737)	(384,323)	(1,294,585)	(1,167,179)
Depreciation	(67,172)	(44,706)	(182,999)	(128,108)
Operating loss	(532,894)	(448,431)	(1,562,118)	(724,733)
Other income (expense):				
Oil and gas lease income, net	31,905	161,430	354,765	484,290
Oil and gas royalty income, net	76,400	262,097	271,002	262,097
Interest income	66,253	6,465	175,356	11,587
Other	(2,671)	12,471	(8,004)	18,418
Net (loss) income from continuing operations	(361,007)	(5,968)	(768,999)	51,659
(Loss) income from discontinued operations, net of taxes	(61,263)	36,215	(21,511)	(97,099)
Net (loss) income	$(422,270)	$30,247	$(790,510)	$(45,440)
Unrealized holding losses	(35,517)	-	(23,335)	-
Total comprehensive (loss) income	$(457,787)	$30,247	$(813,845)	$(45,440)
Basic and diluted net income (loss) per common share –				
Loss from continuing operations	$(0.02)	*	$(0.03)	*
(Loss) earnings from discontinued operations	*	*	*	*
Net loss	$(0.02)	*	$(0.03)	*

Weighted average common shares outstanding – basic	23,754,098	24,037,598	23,795,627	24,037,598
Weighted average common shares outstanding – diluted	23,754,098	24,366,198	23,795,627	24,037,598

* Amount is less than $.01 per share

See accompanying Notes to Consolidated Financial Statements

2

PURE CYCLE CORPORATION
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
Nine months ended May 31, 2016
(unaudited)

	Preferred Stock		Common Stock		Additional Paid-in	Accumulated Other Accumulated Other Comprehensive	Collateral	Accumulated	
	Shares	Amount	Shares	Amount	Capital	Loss	Stock	Deficit	Total
August 31, 2015 balance:	432,513	$433	24,054,098	$80,185	$172,384,355	$-	$(1,407,000)	$(100,972,425)	$70
Share-based compensation	–	–	–	–	167,061	–	–	–	16
Collateral stock retired	–	–	(300,000)	(1,000)	(1,406,000)	–	1,407,000	–	-
Net loss	–	–	–	–	–	–	–	(790,510)	(7
Unrealized holding loss on investments	–	–	–	–	–	(23,335)	–	–	(2
May 31, 2016 balance:	432,513	$433	23,754,098	$79,185	$171,145,416	$(23,335)	$-	$(101,762,935)	$69

See accompanying Notes to Consolidated Financial Statements

3

PURE CYCLE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Nine Months Ended May 31,	
	2016	2015
Cash flows from operating activities:		
Net loss	$(790,510)	$(45,440)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and depletion	307,834	258,909
Investment in Well Enhancement Recover Systems, LLC	8,004	1,565
Stock-based compensation expense	167,061	186,296
Interest income and other non-cash items	(37,299)	(315)
Interest added to receivable from related parties	(22,503)	(10,812)
Changes in operating assets and liabilities:		
Trade accounts receivable	248,731	1,452,996
Sky Ranch receivable	-	(83,500)
Prepaid expenses	(145,826)	63,997
Notes receivable - related parties	(26,483)	(95,500)
Accounts payable and accrued liabilities	(486,170)	(1,115,206)
Income taxes	(292,729)	-
Deferred revenues	(41,852)	(49,037)
Deferred oil and gas lease payment	(354,765)	(484,290)
Net cash provided by (used in) operating activities from continuing operations	(1,466,507)	79,663
Net cash provided by (used in) operating activities from discontinued operations	1,251,527	(535,274)
Net cash used in operating activities	(214,980)	(455,611)
Cash flows from investing activities:		
Purchase of short-term investments	(23,142,484)	-
Purchase of long-term investments	(7,026,424)	-
Investments in water, water systems, and land	(695,746)	(1,900,267)
Purchase of property and equipment	(441,768)	(17,186)
Net cash used in investing activities from continuing operations	(31,306,422)	(1,917,453)
Net cash provided by (used in) investing activities from discontinued operations	(451,347)	699,826
Net cash used in investing activities	(31,757,769)	(1,217,627)
Cash flows from financing activities:		
Payments to contingent liability holders	(1,629)	(7,642)
Net cash used in financing activities from continuing operations	(1,629)	(7,642)
Net cash provided by financing activities from discontinued operations	-	674,710
Net cash (used in) provided by financing activities	(1,629)	667,068
Net change in cash and cash equivalents	(31,974,378)	(1,006,170)
Cash and cash equivalents – beginning of period	37,089,041	1,749,558

Cash and cash equivalents – end of period	$5,114,663	$743,388
SUPPLEMENTAL DISCLSOURES OF NON-CASH ACTIVITIES		
Retirement of collateral stock	$1,407,000	$-
Net reduction in Tap Participation Fee liability and HP A&M receivable collateral stock and mineral rights received as result of settlement of the Arkansas River Agreement	$-	$1,894,203
Assets acquired through WISE funding obligation	$-	$1,400,000

See accompanying Notes to Consolidated Financial Statements

4

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2016

NOTE 1 – PRESENTATION OF INTERIM INFORMATION

The May 31, 2016 consolidated balance sheet, the consolidated statements of operations and comprehensive income (loss) for the three and nine months ended May 31, 2016 and 2015, the consolidated statement of shareholders' equity for the nine months ended May 31, 2016, and the consolidated statements of cash flows for the nine months ended May 31, 2016 and 2015 have been prepared by Pure Cycle Corporation (the "Company") and have not been audited. The unaudited consolidated financial statements include all adjustments that are, in the opinion of management, necessary to present fairly the financial position, results of operations and cash flows at May 31, 2016, and for all periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted. It is suggested that these consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2015 (the "2015 Annual Report") filed with the Securities and Exchange Commission (the "SEC") on November 9, 2015. The results of operations for interim periods presented are not necessarily indicative of the operating results for the full fiscal year. The August 31, 2015 balance sheet was taken from the Company's audited financial statements and was modified to reflect the discontinued operations presentation of the Company's agricultural segment.

Use of Estimates

The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid debt instruments with original maturities of three months or less. The Company's cash equivalents are comprised entirely of money market funds maintained at a reputable financial institution. At various times during the three and nine months ended May 31, 2016, the Company's main operating account exceeded federally insured limits. The Company has never suffered a loss due to such excess balance.

Investments

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

Certificates of deposit and debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. The Company has $7,034,100 of investments classified as held-to-maturity at May 31, 2016 which represent certificates of deposit and U.S. treasury notes with maturity dates after May 31, 2017. Debt securities for which the Company does not have the positive intent or ability to hold to maturity are classified as available-for-sale, along with any investments in equity securities. Securities classified as available-for-sale are marked-to-market at each reporting period. Changes in value on such securities are recorded as a component of Accumulated other comprehensive income (loss). The cost of securities sold is based on the specific identification method. The Company's debt securities mature at various dates through February 12, 2018.

Concentration of Credit Risk and Fair Value

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

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

5

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2016

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

Trade Accounts Receivable – The Company records accounts receivable net of allowances for uncollectible accounts.

Investments – The carrying amounts of investments approximate fair value. Investments are described further in Note 2 – Fair Value Measurements.

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

Long-Term Financial Liabilities – The Comprehensive Amendment Agreement No. 1 (the "CAA") is comprised of a recorded balance and an off-balance sheet or "contingent" obligation associated with the Company's acquisition of its "Rangeview Water Supply" (defined in Note 4 – Water and Land Assets to the 2015 Annual Report). The amount payable is a fixed amount but is repayable only upon the sale of "Export Water" (defined in Note 4 – Water and Land Assets to the 2015 Annual Report). Because of the uncertainty of the sale of Export Water, the Company has determined that the contingent portion of the CAA does not have a determinable fair value. The CAA is described further in Note 4 – Long-Term Obligations and Operating Lease – Participating Interests in Export Water Supply.

Notes Receivable – Related Parties – The market value of the notes receivable – related parties: Rangeview Metropolitan District (the "District") and Sky Ranch Metropolitan District No. 5 are not practical to estimate due to the related party nature of the underlying transactions.

Off-Balance Sheet Instruments – The Company's off-balance sheet instruments consist entirely of the contingent portion of the CAA. Because repayment of this portion of the CAA is contingent on the sale of Export Water, which is not reasonably estimable, the Company has determined that the contingent portion of the CAA does not have a determinable fair value. See further discussion in Note 4 – Long-Term Obligations and Operating Lease – Participating Interests in Export Water Supply.

Revenue Recognition

Wholesale Water and Wastewater Fees – Monthly wholesale water usage charges are assessed to the Company's customers based on actual metered usage each month plus a base monthly service fee. The Company recognizes wholesale water usage revenues upon delivering water to its customers or its governmental customer's end-use customers, as applicable. The export water revenues recognized by the Company are shown gross of royalties to the State of Colorado Board of Land Commissioners (the "Land Board"). The on-site water revenues recognized by the Company are shown net of royalties paid to the Land Board and amounts retained by the District. The Company recognized $35,700 and $73,500 of metered water usage revenues during the three months ended May 31, 2016 and 2015, respectively. The Company recognized $119,800 and $893,700 of metered water usage revenues during the nine months ended May 31, 2016 and 2015, respectively.

The Company recognizes wastewater treatment fees monthly based on usage. The monthly wastewater treatment fees are shown net of amounts retained by the District. The Company recognized $10,500 and $12,300 of wastewater treatment fees during the three months ended May 31, 2016 and 2015, respectively. The Company recognized $31,500 and $37,200 of wastewater treatment fees during the nine months ended May 31, 2016 and 2015, respectively. Costs of delivering water and providing wastewater services to customers are recognized as incurred.

Tap and Construction Fees – The Company has various water and wastewater service agreements, a component of which may include tap and construction fees. The Company recognizes water tap fees as revenue ratably over the estimated service period upon completion of the “Wholesale Facilities” (defined in Part I, Item 1 of the 2015 Annual Report) constructed to provide service to Arapahoe County, Colorado (the “County”). The Company recognized $3,600 and $10,700 of water tap fee revenues during each of the three and nine months ended May 31, 2016 and 2015, respectively. The water tap fees to be recognized over this period are net of the royalty payments to the Land Board and amounts paid to third parties pursuant to the CAA as further described in Note 4 – Long-Term Obligations and Operating Lease below.

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2016

The Company recognized $10,400 and $31,100 of "Special Facilities" (defined in Part I, Item 1 of the 2015 Annual Report) funding as revenue during each of the three and nine months ended May 31, 2016 and 2015, respectively. This is the ratable portion of the Special Facilities funding proceeds received from water agreements as more fully described in Note 2 – Summary of Significant Accounting Policies to the 2015 Annual Report.

As of May 31, 2016, and August 31, 2015, the Company has deferred recognition of approximately $1,125,200 and $1,167,100, respectively, of water tap and construction fee revenue from the County, which will be recognized as revenue ratably over the estimated useful accounting life of the assets constructed with the construction proceeds as described above.

Royalty and Other Obligations

Revenues from the sale of Export Water are shown gross of royalties payable to the Land Board. Revenues from the sale of water on the "Lowry Range" (described in Note 4 – Water and Land Assets in Part II, Item 8 of the 2015 Annual Report) are shown net of the royalties to the Land Board and the amounts retained by the District.

Oil and Gas Lease Payments

As further described in Note 2 – Summary of Significant Accounting Policies in Part II, Item 8 of the 2015 Annual Report, in March 2011, the Company entered into a Paid-Up Oil and Gas Lease (the "O&G Lease") and a Surface Use and Damage Agreement (the "Surface Use Agreement") which was subsequently purchased by a wholly owned subsidiary of ConocoPhillips Company. Pursuant to the O&G Lease, during the year ended August 31, 2011, the Company received an up-front payment of $1,243,400 for the purpose of exploring for, developing, producing and marketing oil and gas on approximately 634 acres of mineral estate owned by the Company at its "Sky Ranch" property (described in Note 4 – Water and Land Assets to the 2015 Annual Report). The Company began recognizing the up-front payments as income on a straight-line basis over three years (the initial term of the O&G Lease) on March 10, 2011. The Company received an additional payment of $1,243,400 during February 2014 to extend the O&G Lease an additional two years through February 2016, which was recognized as income on a straight-line basis over two years (the extension term of the O&G Lease). During the fiscal year ended August 31, 2014, the Company received an up-front payment of $72,000 for the purpose of exploring for, developing, producing, and marketing oil and gas on 40 acres of mineral estate the Company owns adjacent to the Lowry Range (the "Rangeview Lease"). The Company recognized $31,900 and $161,400 during the three months ended May 31, 2016 and 2015, respectively, of lease income related to the up-front payments received pursuant to the O&G Lease and the Rangeview Lease. The Company recognized $354,800 and $484,300 during the nine months ended May 31, 2016 and 2015, respectively, of lease income related to the up-front payments received pursuant to the O&G Lease and the Rangeview Lease.

As of May 31, 2016 and August 31, 2015, the Company has deferred recognition of $25,000 and $379,800, respectively, of income related to the O&G Lease and the Rangeview Lease. The balance as of May 31, 2016 will be recognized into income ratably through July 2017. $354,800 of the balance as of August 31, 2015 was recognized into income during the nine months ended May 31, 2016.

During the three months ended February 28, 2015, two wells were drilled within the Company's mineral interest. Beginning in March 2015, both wells were placed into service and began producing oil and gas and accruing royalties to the Company. In May 2015, certain gas collection infrastructure was extended to the property to allow the collection of gas from the wells and accrual of royalties attributable to gas production. During the three months ended May 31, 2016 and 2015, the Company received $76,400 and $262,100, respectively, in royalties attributable to these two wells. During the nine months ended May 31, 2016 and 2015, the Company received $271,000 and $262,100 respectively, in royalties attributable to these two wells.

Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the eventual use of the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2016

Capitalized Costs of Water and Wastewater Systems and Depletion and Depreciation of Water Assets

Costs to construct water and wastewater systems that meet the Company's capitalization criteria are capitalized as incurred, including interest, and depreciated on a straight-line basis over their estimated useful lives of up to 30 years. The Company capitalizes design and construction costs related to construction activities, and it capitalizes certain legal, engineering and permitting costs relating to the adjudication and improvement of its water assets. The Company depletes its groundwater assets that are being utilized on the basis of units produced (i.e., thousands of gallons sold) divided by the total volume of water adjudicated in the water decrees.

Share-Based Compensation

The Company maintains a stock option plan for the benefit of its employees and non-employee directors. The Company records share-based compensation costs as expense over the applicable vesting period of the stock award using the straight-line method. The compensation costs to be expensed are measured at the grant date based on the fair value of the award. The Company has adopted the alternative transition method for calculating the tax effects of share-based compensation, which allows for a simplified method of calculating the tax effects of employee share-based compensation. Because the Company has a full valuation allowance on its deferred tax assets, the granting and exercise of stock options has no impact on the income tax provisions. The Company recognized $58,200 and $53,700 of share-based compensation expense during the three months ended May 31, 2016 and 2015, respectively. The Company recognized $167,100 and $186,300 of share-based compensation expense during the nine months ended May 31, 2016 and 2015, respectively.

Income Taxes

The Company uses a "more-likely-than-not" threshold for the recognition and de-recognition of tax positions, including any potential interest and penalties relating to tax positions taken by the Company. The Company did not have any significant unrecognized tax benefits as of May 31, 2016.

The Company files income tax returns with the Internal Revenue Service and the State of Colorado. The tax years that remain subject to examination are fiscal year 2013 through fiscal year 2015. The Company does not believe there will be any material changes in its unrecognized tax positions over the next 12 months.

The Company's policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. At May 31, 2016, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the three or nine months ended May 31, 2016 or 2015.

Discontinued Operations

In August 2015, the Company sold its Arkansas River water and land properties. Pursuant to the terms of the purchase and sale agreement, the Company continued to manage and receive the lease income until December 31, 2015. The operating results and the assets and liabilities of the discontinued operations, which formerly comprised the agricultural segment, are presented separately in the Company's Consolidated Financial Statements. Summarized financial information for the discontinued agricultural business is shown below. Prior period balances have been reclassified to present the operations of the agricultural business as a discontinued operation.

8

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2016

Discontinued Operations Income Statement

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2016	2015	2016	2015
Farm revenues	$-	$270,582	$275,991	$818,925
Farm expenses	(22,674)	(23,131)	(56,042)	(70,001)
Gross (loss) profit	(22,674)	247,451	219,949	748,924
General and administrative expenses	48,346	140,366	287,787	617,914
Operating (loss) profit	(71,020)	107,085	(67,838)	131,010
Finance charges	9,757	7,909	42,054	17,622
Gain on sale of farm assets	-	-	4,273	-
Interest expense	-	(78,779)	-	(221,915)
Interest imputed on the Tap Participation Fee payable to HP A&M	-	-	-	(23,816)
Income (loss) from discontinued operations	$(61,263)	$36,215	$(21,511)	$(97,099)

The Company anticipates continued expenses through the end of calendar 2016 related to the discontinued operations. The Company will continue to incur expenses related to the remaining agricultural land the Company continues to own and for the purpose of collecting outstanding receivables.

The individual assets and liabilities of the discontinued agricultural business are combined in the captions “Assets of discontinued operation” and “Liabilities of discontinued operation” in the consolidated Balance Sheet. The carrying amounts of the major classes of assets and liabilities included part of the discontinued business are presented in the following table:

Discontinued Operations Balance Sheet

	May 31, 2016	August 31, 2015

Assets:		
Trade accounts receivable	$351,218	$307,913
Escrow receivable	-	1,342,250
Land held for sale (*)	450,347	-
Prepaid expenses	-	65,309
Total assets	$801,565	$1,715,472
Liabilities:		
Accounts payable	$135	$25,704
Accrued liabilities	3,467	90,725
Deferred revenues	-	900
Total liabilities	$3,602	$117,329

(*) Land Held for Sale. During the fiscal quarter ended November 30, 2015, the Company purchased three farms for approximately $450,300. The Company acquired a total of 700 acres. The farms were acquired in order to correct dry-up covenant issues related to water only farms in order obtain the release of the escrow funds related to the Company's farm sale to Arkansas River Farms, LLC. The Company intends to sell the farms within the next fiscal year.

Income (Loss) per Common Share

Income (loss) per common share is computed by dividing net income (loss) by the weighted average number of shares outstanding during each period. Common stock options and warrants aggregating 338,100 and 341,100 common share equivalents were outstanding as of May 31, 2016 and 2015, respectively, and have been included in the calculation of net income per common share but excluded from the calculation of loss per common share as their effect is anti-dilutive.

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2016

Recently Issued Accounting Pronouncements

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

In May 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients. ASU 2016-12 provides for amendments to ASU No. 2014-09, Revenue from Contracts with Customers, amending the guidance on transition, collectability, noncash consideration and the presentation of sales and other similar taxes. Specifically, ASU 2016-12 clarifies that, for a contract to be considered completed at transition, all (or substantially all) of the revenue must have been recognized under legacy GAAP. In addition, ASU 2016-12 clarifies how an entity should evaluate the collectability threshold and when an entity can recognize nonrefundable consideration received as revenue if an arrangement does not meet the standard's contract criteria. The Company is assessing the impact of ASU 2016-12, but it does not expect the adoption of ASU 2016-12 to have a material impact on its financial statements.

In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing. ASU 2016-10 provides for amendments to ASU No. 2014-09, Revenue from Contracts with Customers, reducing the complexity when applying the guidance for identifying performance obligations and improving the operability and understandability of the license implementation guidance. The Company is assessing the impact of ASU 2016-10, but it does not expect the adoption of ASU 2016-10 to have a material impact on its financial statements.

In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net). ASU 2016-08 provides for amendments to ASU No. 2014-09, Revenue from Contracts with Customers, clarifying the implementation guidance on principal versus agent considerations in the new revenue recognition standard. Specifically, ASU 2016-08 clarifies how an entity should identify the unit of accounting (i.e., the specified good or service) for the principal versus agent evaluation and how it should apply the control principle to certain types of arrangements. The Company is assessing the impact of ASU 2016-08, but it does not expect the adoption of ASU 2016-08 to have a material impact on its financial statements.

In April 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. ASU 2014-08 changes the presentation and disclosure requirements for discontinued operations. The update was adopted by the Company in fiscal year 2016.

NOTE 2 – FAIR VALUE MEASUREMENTS

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

Level 1 — Valuations for assets and liabilities traded in active exchange markets, such as the NASDAQ Stock Market. The Company had none of these instruments as of May 31, 2016 or August 31, 2015.

Level 2 — Valuations for assets and liabilities obtained from readily available pricing sources via independent providers for market transactions involving similar assets or liabilities. The Company had 35 Level 2 assets as of May 31, 2016, which consist of certificates of deposit and U.S. treasury notes. The Company had no Level 2 assets or liabilities as of August 31, 2015.

Level 3 — Valuations for assets and liabilities that are derived from other valuation methodologies, including discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker-traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities. The Company had no Level 3 liability as of May 31, 2016 or August 31, 2015.

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PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2016

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

Level 2 Asset – Available for Sale Securities. The Company's available for sale securities are the Company's only financial asset measured at fair value on a recurring basis. The fair value of the available for sale securities is based on the values reported by the financial institutions where the funds are held. These securities include only federally insured certificates of deposit.

The Company's non-financial assets measured at fair value on a non-recurring basis consist entirely of its investments in water and water systems, land held for sale, and other long-lived assets. See Note 3 – Water and Land Assets below.

The following table provides information on the assets and liabilities measured at fair value on a recurring basis as of May 31, 2016:

			Fair Value Measurement Using:			
		Cost / Other	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	Accumulated Unrealized Gains and
	Fair Value	Value	(Level 1)	(Level 2)	(Level 3)	(Losses)
Available for sale	$23,148,500	$23,171,800	$-	$23,148,500	$-	$(23,300)

NOTE 3 – WATER AND LAND ASSETS

The Company's water rights and current water and wastewater service agreements are more fully described in Note 4 – Water and Land Assets in Part II, Item 8 of the 2015 Annual Report. There have been no significant changes to the Company's water rights or water and wastewater service agreements during the three and nine months ended May 31, 2016.

The Company's Investments in Water and Water Systems consist of the following costs and accumulated depreciation and depletion at May 31, 2016 and August 31, 2015:

	May 31, 2016	August 31, 2015
	Costs	Costs

		Accumulated Depreciation and Depletion		Accumulated Depreciation and Depletion
Rangeview water supply	$14,444,600	$(9,000)	$14,444,600	$(8,800)
Sky Ranch water rights and other costs	6,444,500	(268,000)	6,440,800	(194,600)
Fairgrounds water and water system	2,899,900	(864,800)	2,899,900	(798,700)
Rangeview water system	1,256,300	(141,400)	1,256,300	(110,300)
Water supply – other	4,479,000	(271,900)	3,973,300	(193,900)
Totals	29,524,300	(1,555,100)	29,014,900	(1,306,300)
Net investments in water and water systems	$27,969,200		$27,708,600	

Capitalized terms in this section not defined herein are defined in Note 4 – Water and Land Assets to the 2015 Annual Report.

Depletion and Depreciation. The Company recorded depletion charges of $100 and $500 during the three months ended May 31, 2016 and 2015, respectively. The Company recorded depletion charges of $200 and $6,700 during the nine months ended May 31, 2016 and 2015, respectively. During the three and nine months ended May 31, 2016, this related entirely to the Rangeview Water Supply, and during the three and nine months ended May 31, 2015, this related to the Rangeview Water Supply and the Sky Ranch water assets.

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2016

The Company recorded $108,700 and $86,300 of depreciation expense during the three months ended May 31, 2016 and 2015, respectively. The Company recorded $307,600 and $252,200 of depreciation expense during the nine months ended May 31, 2016 and 2015, respectively.

NOTE 4 – LONG-TERM OBLIGATIONS AND OPERATING LEASE

The Participating Interests in Export Water Supply is an obligation of the Company that has no scheduled maturity date. Therefore, maturity of this liability is not disclosed in tabular format, but is described below.

Participating Interests in Export Water Supply

The Company acquired its Rangeview Water Supply through various amended agreements entered into in the early 1990s. The acquisition was consummated with the signing of the CAA in 1996. Upon entering into the CAA, the Company recorded an initial liability of $11.1 million, which represented the cash the Company received from the participating interest holders that was used to purchase the Company's Export Water (described in greater detail in Note 4 – Water and Land Assets to the 2015 Annual Report). The Company agreed to remit a total of $31.8 million of proceeds received from the sale of Export Water to the participating interest holders in return for their initial $11.1 million investment. The obligation for the $11.1 million was recorded as debt, and the remaining $20.7 million contingent liability was not reflected on the Company's balance sheet because the obligation to pay this is contingent on the sale of Export Water, the amounts and timing of which are not reasonably determinable.

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

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

From time to time, the Company repurchased various portions of the CAA obligations, which retained their original priority. The Company did not make any CAA acquisitions during the nine months ended May 31, 2016 or 2015.

As a result of the acquisitions and the sale of Export Water, as detailed in the table below, the remaining potential third-party obligation at May 31, 2016, is approximately $1 million, and the Company has the right to approximately $29.8 million in Export Water proceeds:

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2016

	Export Water Proceeds Received	Initial Export Water Proceeds to Pure Cycle	Total Potential Third-Party Obligation	Paticipating Interests Liability	Contingency
Original balances	$–	$218,500	$31,807,700	$11,090,600	$20,717,100
Activity from inception until August 31, 2015:					
Acquisitions	–	30,428,900	(30,428,900)	(10,622,100)	(19,806,800)
Option payments - Sky Ranch					