PICO HOLDINGS INC /NEW
Form 10-K
March 12, 2007

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

OR

o **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 0-18786

PICO HOLDINGS, INC.
(Exact Name of Registrant as Specified in its Charter)

California	**94-2723335**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

875 Prospect Street, Suite 301
La Jolla, California 92037
(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code (858) 456-6022

Securities Registered Pursuant to Section 12(b) of the Act:
Common Stock, Par Value $.001, Listed on The NASDAQ Stock Market LLC

Securities Registered Pursuant to Section 12(g) of the Act:
None

Indicate by check mark whether the registrant is a well known seasoned issuer, as defined by Rule 405 of the Securities Act.
Yes o 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 o 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 o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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 or this Form 10-K or any amendment to this Form 10-K. x

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

Large accelerated filer o   Accelerated filer x   Non-accelerated filer o

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

Approximate aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates of the registrant (based on the closing sales price of such stock as reported in the NASDAQ Global Market) as of June 30, 2006 the last business day of the registrant's most recently completed second fiscal quarter, was $400,381,041.

On March 9, 2007, the registrant had 23,129,923 shares of common stock, $.001 par value, outstanding, excluding 3,219,243 shares of common stock which are held by the registrant's subsidiaries.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Definitive Proxy Statement to be filed with the Commission pursuant to Regulation 14A in connection with the registrant's 2007 Annual Meeting of Shareholders, to be filed subsequent to the date hereof, are incorporated by reference into Part III of this Report. Such Definitive Proxy Statement will be filed with the Securities and Exchange Commission not later than 120 days after the conclusion of the registrant's fiscal year ended December 31, 2006.

PICO HOLDINGS, INC.

ANNUAL REPORT ON FORM 10-K

TABLE OF CONTENTS

1

Table of Contents

PART I

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the Consolidated Financial Statements and Notes thereto included elsewhere in this Annual Report on Form 10-K.

This Annual Report on Form 10-K (including the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section) contains "forward-looking statements" regarding our business, financial condition, results of operations and prospects, including, without limitation, statements about our expectations, beliefs, intentions, anticipated developments, and other information concerning future matters. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates" and similar expres variations of such words are intended to identify forward-looking statements, but are not the exclusive means of identifying forward-looking statements in this Annual Report on Form 10-K.

Although forward-looking statements in this Annual Report on Form 10-K reflect the good faith judgment of our management, such statements can only be based on facts and factors currently known by us. Consequently, forward-looking statements are inherently subject to risks and uncertainties, and the actual results and outcomes could differ from those discussed in or anticipated by the forward-looking statements. Factors that could cause or contribute to such differences in results and outcomes include, without limitation, those discussed under the heading "Risk Factors" below, as well as those discussed elsewhere in this Annual Report on Form 10-K. Readers are urged not to place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K We undertake no obligation to revise or update any forward-looking statements in order to reflect any event or circumstance that may arise after the date of this Annual Report on Form 10-K. Readers are urged to carefully review and consider the various disclosures made in this Annual Report on Form 10-K, which attempt to advise interested parties of the risks and factors that may affect our business, financial condition, results of operations, and prospects.

ITEM 1. BUSINESS

Introduction

PICO Holdings, Inc. (PICO and its subsidiaries are collectively referred to as "PICO" and "the Company," and by words such as "we," and "our") is a diversified holding company. We seek to build and operate businesses where significant value can be created from the development of unique assets, and to acquire businesses which we identify as undervalued and where our participation can aid in the recognition of the business's fair value, as well as create additional value.

Our objective is to maximize long-term shareholder value. We manage our operations to achieve a superior return on net assets over the long term, as opposed to short-term earnings.

Our business is separated into four major operating segments:

- Water Resource and Water Storage Operations;
- Real Estate Operations;
- Business Acquisitions & Financing (which contains businesses, interests in businesses, and other parent company assets); and
- Insurance Operations in "Run Off".

Currently our major consolidated subsidiaries are:

·

Vidler Water Company, Inc. (“Vidler”), a business we started more than 10 years ago, which develops and owns water resources and water storage operations in the southwestern United States, primarily in Nevada and Arizona;

- Nevada Land and Resource Company, LLC (“Nevada Land”), an operation that we have built since we acquired the company more than 10 years ago, which currently owns approximately 560,000 acres of land in Nevada, and certain mineral rights and water rights related to the property;
- Physicians Insurance Company of Ohio (“Physicians”), which is “running off” its medical professional liability insurance loss reserves, and was our original business historically;
- Citation Insurance Company (“Citation”), which is “running off” its historical property & casualty and workers’ compensation loss reserves. Citation was acquired because it was complimentary to our other insurance operations at the time; and
- Global Equity AG, which holds our interest in Jungfraubahn Holding AG (“Jungfraubahn”). Jungfraubahn is a public company, whose shares trade on the SWX Swiss Exchange, that operates railway and related tourism and transport activities in the Swiss Alps. We believed that Jungfraubahn was significantly undervalued at the time we acquired our interest, which was primarily acquired between 1999 and 2003.

During 2006, HyperFeed Technologies, Inc. filed for Chapter 7 bankruptcy protection. HyperFeed is accounted for in our consolidated financial statements for 2006 and prior years as a discontinued operation. *See “Discontinued Operations.”*

The address of our main office is 875 Prospect Street, Suite 301, La Jolla, California 92037, and our telephone number is (858) 456-6022.

Table of Contents

Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports are made available on our website (www.picoholdings.com) as soon as reasonably practicable after the reports are electronically filed with the SEC. Our website also contains other material about PICO, and links to other sites, including some of the companies with which we are associated.

History

PICO was incorporated in 1981 and began operations in 1982. The company was known as Citation Insurance Group until a reverse merger with Physicians Insurance Company of Ohio on November 20, 1996. After the reverse merger, the former shareholders of Physicians owned approximately 80% of Citation Insurance Group, the Board of Directors and management of Physicians replaced their Citation counterparts, and Citation Insurance Group changed its name to PICO Holdings, Inc. You should be aware that some data on Bloomberg and other information services pre-dating the reverse merger relates to the old Citation Insurance Group only, and does not reflect the performance of Physicians prior to the merger.

Operating Segments and Major Subsidiary Companies

The following is a description of our operating segments and major subsidiaries. Unless otherwise indicated, we own 100% of each subsidiary.

Water Resource and Water Storage Operations

Water Resource and Water Storage Operations are primarily conducted through Vidler Water Company.

Vidler is a leading private company in the water resource development business in the southwestern United States. PICO identified water resource development in the Southwest as an attractive business opportunity due to the continued growth in demand for water, primarily as a result of population growth and economic development. We develop new sources of water for municipal and industrial use, and storage infrastructure to facilitate the efficient allocation of available water supplies. Vidler is not a water utility, and does not intend to enter into regulated utility activities.

The inefficient allocation of available water between agricultural users and municipal or industrial users, or the lack of available known water supply in a particular location, provide opportunities for Vidler:

- the majority of water rights are currently owned or controlled by agricultural users, and in many locations there are insufficient water rights owned or controlled by municipal and industrial users to meet present and future demand;
- certain areas of the Southwest experiencing rapid growth have insufficient known supplies of water to support future growth. Vidler identifies and develops new water supplies for communities with no other known water resources to support future growth. In certain cases, to supply water from the water resources identified by Vidler, it may require regulatory approval to import the water from its source to where development is occurring, or substantial infrastructure to convey the water. Vidler is able to assess the likelihood of being able to get the necessary approval to import water, and to build the infrastructure in a timely and economic manner. In cases where we assess that water importation is possible, Vidler has demonstrated an ability to obtain all of the required approval and entitlements, and to manage the building of the infrastructure necessary to import and convey the identified water from its source to development; and
- currently there are not effective procedures in place for the transfer of water from private parties with excess supply in one state to end-users in other states. However, regulations and procedures are steadily being developed to facilitate the interstate transfer of water. Infrastructure to store water will be required to accommodate and allow

interstate transfer, and transfers from wet years to dry years. Currently there is limited storage capacity in place.

We entered the water resource development business with the acquisition of Vidler in 1995. At the time, Vidler owned a limited quantity of water rights and related assets in Colorado. Since then, Vidler has acquired or developed:

- additional water rights and related assets, predominantly in Nevada and Arizona, the two leading states in population growth and new home construction. A water right is the legal right to divert water and put it to beneficial use. Water rights are assets which can be bought and sold. In some states, the use of the water can also be leased. The value of a water right depends on a number of factors, including location, the seniority of the right, and whether or not the right is transferable. Vidler seeks to acquire water rights at prices consistent with their current use, with the expectation of an increase in value if the water right can be converted to a higher use. Our objective is to monetize our water rights for municipal and industrial use. Typically, our water resources are the most competitive source of water (i.e., the most economical and practical source of water supply) to support new growth in municipalities and new industry; and
- a water storage facility in Arizona and an interest in Semitropic, a water storage facility in California. At December 31, 2006, Vidler had “net recharge credits” (i.e. an acre foot of water) representing more than 115,000 acre-feet of water in storage on its own account at the Vidler Arizona Recharge Facility. An acre-foot is a unit commonly used to measure the volume of water, being the volume of water required to cover one acre to a depth of one foot. As a rule of thumb, one acre-foot of water would sustain two families of four persons each for one year.

Table of Contents

Vidler is engaged in the following activities:

- supplying water to end-users in the Southwest, namely water utilities, municipalities, developers, or industrial users. The source of water could be from identifying and developing a new water supply, or a change in the use of water from agricultural to municipal and industrial; and
- development of storage and distribution infrastructure to generate cash flow from the purchase and storage of water for resale, and charging customers fees for "recharge," or placing water into storage.

Vidler's priority is to either monetize or develop recurring cash flow from its most important assets by:

- securing supply contracts utilizing its water rights in Nevada; and
- storing additional water at the Vidler Arizona Recharge Facility, and providing water supplies from net recharge credits (a recharge credit is an acre-foot of water) already in storage.

Vidler has also entered into "teaming" arrangements with parties who have water assets but lack the capital or expertise to commercially develop these assets. The first such arrangement is a water delivery teaming agreement with Lincoln County ("Lincoln/Vidler"), which is developing water resources in Lincoln County, Nevada. Vidler continues to explore additional teaming opportunities throughout the Southwest.

The following table details the water rights and water storage assets owned by Vidler at December 31, 2006. Please note that this is intended as a summary, and that some numbers are rounded. Item 7 of this Form 10-K contains more detail about these assets, recent developments affecting them, and the current outlook.

Name of asset & approximate location	**Brief Description**	**Present commercial use**
WATER RESOURCES		
Arizona:		
Harquahala Valley ground water basin La Paz County 75 miles northwest of metropolitan Phoenix	2,703 acres of land 2,880 acre-feet of transferable ground water	Leased to farmers
Nevada:		
Fish Springs Ranch, LLC (51% interest) & V&B, LLC (100% interest) Washoe County, 40 miles north of Reno	8,600 acres of deeded ranch land 13,000 acre-feet of permitted water rights, 8,000 of which are transferable to the Reno/Sparks area	Vidler is currently farming the property. Cattle graze on part of the property on a revenue- sharing basis Vidler is constructing a 35 mile long pipeline to convey 8,000 acre-feet of water annually from Fish Springs Ranch to the North Valleys of Reno, Nevada

Table of Contents

Lincoln County water delivery teaming agreement	Applications* for more than 100,000 acre-feet of water rights through an agreement with Lincoln County. It is currently anticipated that up to 40,000 acre-feet of the applications will be permitted, and the water put to use in Lincoln County / northern Clark County **The numbers indicated for water rights applications are the maximum amount which we have filed for. In some cases, we anticipate that the actual permits received will be for smaller quantities*	Agreement to sell 7,240 acre-feet of water as, and when, supplies are permitted from existing applications Agreement to sell water to a developer as, and when, supplies are permitted from applications in Kane Springs Basin in Lincoln County, Nevada
Clark County		
Sandy Valley Near the Nevada / California state line in the Interstate 15 corridor	415 acre-feet of permitted water rights Application for 1,000 acre-feet of water rights	Agreement to sell at least 415 acre-feet of water pending resolution of a protest of the permitting of the water rights
Muddy River water rights In the Moapa Valley, approximately 35 miles east of Las Vegas in the Interstate 15 corridor	221 acre-feet of water rights, plus approximately 46 acre-feet under option	
Colorado:		
Colorado water rights	180 acre-feet of water rights	66 acre-feet leased. 114 acre-feet are available for sale or lease
WATER STORAGE		
Arizona:		
Vidler Arizona Recharge Facility Harquahala Valley, Arizona	An underground water storage facility with estimated capacity exceeding 1 million acre-feet and annual recharge capability of up to 35,000 acre-feet	Vidler is currently buying water and storing it on its own account. At December 31, 2006, Vidler had net recharge credits equivalent to approximately 115,000 acre-feet of water in storage at the Arizona Recharge Facility. In addition, Vidler has purchased or ordered approximately 30,000 acre-feet of water for recharge in 2007.
California:		
Semitropic water storage facility	The right to store 30,000 acre-feet of water underground until 2035. This	

includes the right to minimum guaranteed recovery of approximately 2,700 acre-feet of water every year, and the right to recover up to approximately 6,800 acre-feet in one year in certain circumstances

Real Estate Operations

Real Estate Operations are conducted through Nevada Land And Resource Company, LLC.

In April 1997, PICO paid $48.6 million to acquire Nevada Land, which at the time owned approximately 1,352,723 acres of deeded land in northern Nevada, and the water, mineral, and geothermal rights related to the property. Much of Nevada Land's property is checker-boarded in square mile sections with publicly owned land. The lands generally parallel the Interstate 80 corridor and the Humboldt River, from Fernley, in western Nevada, to Elko County, in northeast Nevada.

Nevada Land is one of the largest private landowners in the state of Nevada. According to U.S. Census Bureau data, Nevada has experienced the most rapid population growth of any state in the United States for 19 of the past 20 years, being narrowly edged out by Arizona in 2006. The population of Nevada increased 66% in the 10 years ended April 1, 2000, and increased another 25%, to approximately 2.5 million people, from 2000 to 2006. Most of the growth is centered in southern Nevada, which includes the city of Las Vegas and surrounding municipalities. Land available for private development in Nevada is relatively scarce, as governmental agencies own approximately 87% of the land in Nevada.

Table of Contents

Before we acquired Nevada Land, the property had been under the ownership of a succession of railway companies, to whom it was a non-core asset. Accordingly, when we acquired Nevada Land, we believed that the commercial potential of the property had not been maximized.

After acquiring Nevada Land, we completed a “highest and best use” study which divided the land into categories. We developed strategies to maximize the value of each category, with the objective of monetizing assets once they had reached their highest and best use. These strategies include:

- the sale of land and water rights. There is demand for land and water for a variety of purposes including residential development, residential estate living, farming, ranching, and from industrial users;
- the development of water rights. Nevada Land has applied for additional water rights on land it owns and intends to improve. Where water rights are permitted, we anticipate that the value, productivity, and marketability of the related land will increase;
- the development of land in and around growing municipalities; and
- the management of mineral rights.

During the period from April 23, 1997 to December 31, 2006, Nevada Land received consideration of approximately $70.1 million from the sale and exchange of land, and the sale of water rights. This is comprised of $69 million from the sale and exchange of land, and $1.1 million from the sale of water rights related to land that was sold. Over this period, we divested approximately 814,000 acres of land at an average price of $85 per acre, which compares to our average basis of $35 in the acres disposed of. The average gross margin percentage on the disposal of land and water rights over this period is 59.6%. The average cost for the total land, water, and mineral assets acquired with Nevada Land was $35 per acre.

At December 31, 2006, Nevada Land owned approximately 541,000 acres of former railroad land. In addition to the former railroad property, Nevada Land acquired:

- 17,558 acres of land in a land exchange with a private landowner. This land is contiguous with Native American tribal lands and is culturally sensitive; and
- Spring Valley Ranches, which originally consisted of 8,717 acres of deeded land, located approximately 40 miles east of Ely in White Pine County, Nevada. During 2006, we sold approximately 7,675 acres of land and related water assets at Spring Valley.

In recent years, Nevada Land has filed additional applications for approximately 50,600 acre-feet of water rights on the Company’s former railroad lands. Of these applications, approximately 12,400 acre-feet of water rights have been certificated and permitted, and applications are pending for approximately 38,200 acre-feet of water use for agricultural, municipal, and industrial use. Potentially, some of these water rights could be utilized to support the growth of municipalities in northern Nevada.

Table of Contents

Business Acquisitions and Financing

This segment contains businesses, interests in businesses, and other parent company assets.

We do not sell holdings on a regular basis. A holding may be sold if the price of a security has significantly exceeded our target, or if there have been changes which we believe limit further appreciation potential on a risk-adjusted basis. Consequently, the amount of net realized gains or losses recognized during any accounting period has no predictive value. In addition, in this segment various income items relate to specific holdings owned during a particular accounting period. Since our holdings change over time, results in this segment are not necessarily comparable from year to year.

The largest asset in this segment is our 22.5% interest in Jungfraubahn Holding AG (“Jungfraubahn”), which had a market value and carrying value (before taxes) of $49.1 million at the end of 2006. The holding in Jungraubahn, and our residual holding in Raetia Energie AG, are the only interests in publicly-traded companies in this segment.

PICO seeks to acquire businesses and interests in businesses which we identify as undervalued based on fundamental analysis -- that is, our assessment of what the business is worth, based on the private market value of its assets, earnings, and cash flow. Typically, the business will be generating free cash flow and have a low level of debt, or, alternatively, strong interest coverage ratios or the ability to realize surplus assets. As well as being undervalued, the business must have special qualities such as unique assets, a potential catalyst for change, or be in an industry with attractive economics. We are also interested in acquiring businesses and interests in businesses where there is significant unrecognized value in land and other tangible assets.

We have acquired businesses and interests in businesses through the acquisition of private companies, and the purchase of shares in public companies, both directly through participation in financing transactions and through open market purchases.

When we acquire an interest in a public company, we are prepared to play an active role, for example encouraging companies to use proper financial criteria when making capital expenditure decisions, or by providing financing or strategic input.

At the time we acquire an interest in a public company, we believe that the intrinsic value of the underlying business significantly exceeds the current market capitalization. The gap between market price and intrinsic value may persist for several years, and the stock price may decline while our estimate of intrinsic value is stable or increasing. Sometimes the gap is not eliminated until another party attempts to acquire the company.

When acquisitions become core operations, typically through majority ownership, we become involved in the management and strategic direction of the business. If we acquire majority ownership, the business may become a separate segment in our consolidated financial statements.

Insurance Operations in “Run Off”

This segment consists of Physicians Insurance Company of Ohio and Citation Insurance Company.

Physicians Insurance Company of Ohio

Until 1995, Physicians wrote medical professional liability insurance, mostly in the state of Ohio. In 1995 we concluded that maximum value would be obtained by placing Physicians in “run off.” This means handling and resolving the claims arising from its historical business, but not writing new business.

After Physicians went into “run off,” the company expanded its insurance operations by acquisition:

- In 1995, we purchased Sequoia Insurance Company, which primarily wrote commercial lines of insurance in California and Nevada. After the acquisition, we re-capitalized Sequoia, which provided the capital to support growth in the book of business; and

- In 1996, Physicians completed a reverse merger with the parent company of Citation Insurance Company. At that time, Citation wrote various lines of commercial property and casualty insurance and workers' compensation insurance, primarily in California and Arizona. The operations of Sequoia and Citation were combined, and eventually the business previously written by Citation was transferred to Sequoia. At the end of 2000, Citation ceased writing business and went into "run off". In 2003, we sold Sequoia Insurance Company. Despite significant growth in its book of business, and combined ratios and investment return better than the industry averages, Sequoia continued to generate a return on capital lower than our expectation, and we concluded that value would be maximized by the sale of Sequoia, particularly given the increasingly restrictive regulatory environment and the highly competitive marketplace.

Physicians and Citation obtain the funds to pay claims from the maturity of fixed-income securities, the sale of investments, and collections from reinsurance companies (that is, specialized insurance companies who share in our claims risk).

Typically, most of the revenues of an insurance company in "run off" come from investment income on funds held as part of the insurance business. During the "run off" process, as claims are paid, both the loss reserve liabilities and the corresponding fixed-income investment assets decrease. Since interest income in this segment will decline over time, we are attempting to minimize segment overhead expenses as much as possible.

Table of Contents

Although we regularly evaluate the strategic alternatives, we currently believe that the most advantageous option is for Physicians' own claims personnel to manage the "run off." We believe that this will ensure a high standard of claims handling for our policyholders and, from the Company's perspective, ensure the most careful examination of claims made to minimize loss and loss adjustment expense payments. If we were to reinsure Physicians' entire book of business and outsource claims handling, this would involve giving up management of the corresponding investment assets.

Administering our own "run off" also provides us with the following opportunities:
- we retain management of the associated investment portfolios. After we resumed direct management of our insurance company portfolios in 2000, we believe that the return on our portfolio assets has been attractive in absolute terms, and very competitive in relative terms (see next paragraph). Since the claims reserves of the "run off" insurance companies effectively recognize the cost of paying and handling claims in future years, the investment return on the corresponding investment assets, less non-insurance expenses, accrues to PICO. We aim to maximize this source of income; and
- to participate in favorable development in our claims reserves if there is any, although this entails the corresponding risk that we could be exposed to unfavorable development.

As the "run off" progresses, at an indeterminate time in the future, Physicians' claims reserves may diminish to the point where it is more cost-effective to outsource claims handling to a third party administrator.

At December 31, 2006, Physicians had $9.4 million in medical professional liability loss reserves, net of reinsurance.

Citation Insurance Company

In 1996, Physicians completed a reverse merger with Citation's parent company. In the past, Citation wrote various lines of commercial property and casualty insurance and workers' compensation insurance, primarily in California and Arizona.

After we assumed management of Citation, we tightened underwriting standards significantly and did not renew much of the business which Citation had written previously. At the end of 2000 Citation ceased writing business and went into "run off."

Prior to the reverse merger, Citation had been a direct writer of workers' compensation insurance. Since PICO did not wish to be exposed to that line of business, shortly after the merger was completed Citation reinsured 100% of its workers compensation business with a subsidiary, Citation National Insurance Company ("CNIC"), and sold CNIC to Fremont Indemnity Company ("Fremont") in a third-party transaction in 1997. As part of the sale of CNIC, all assets and liabilities, including the assets which corresponded to the workers' compensation reserves reinsured with CNIC, and all records, computer systems, policy files, and reinsurance arrangements were transferred to Fremont. Fremont merged CNIC into Fremont, and administered and paid all of the workers' compensation claims which had been sold to it. From 1997 until the second quarter of 2003, Citation booked the losses reported by Fremont, and recorded an equal and offsetting reinsurance recoverable from Fremont, as an admitted reinsurer, for all losses and loss adjustment expenses. This resulted in no net impact on Citation's reserves and financial statements, and no net impact on PICO's consolidated financial statements.

In June 2003, the California Department of Insurance obtained a conservation order over Fremont, and applied for a court order to liquidate Fremont. In July 2003, the California Superior Court placed Fremont in liquidation. Since Fremont was no longer an admitted reinsurance company under the statutory basis of insurance accounting, Citation reversed the $7.5 million reinsurance recoverable from Fremont in both its statutory basis and GAAP basis financial statements in the 2003 financial year. Citation was unsuccessful in court action to recover deposits reported as held by Fremont for Citation's insureds.

In September 2004, Citation entered into a third-party administration agreement with Cambridge Integrated Services, Inc. to administer the claims handling and claims payment for Citation's workers' compensation insurance run-off book of business.

At December 31, 2006, Citation had $14.7 million in loss reserves, net of reinsurance. Citation's loss reserves consist of $5.1 million for property and casualty insurance, principally in the artisans/contractors line of business, and $9.6 million for workers' compensation insurance.

Table of Contents

Discontinued Operations

HyperFeed Technologies, Inc.
During the fourth quarter of 2006, our majority-owned subsidiary HyperFeed Technologies, Inc. ("HyperFeed") filed for bankruptcy protection under Chapter 7 of the U.S. Bankruptcy Code. Consequently, HyperFeed is now recorded as a discontinued operation for 2006 and prior years in the Consolidated Financial Statements in this Annual Report on Form 10-K.

HyperFeed was a provider of enterprise-wide ticker plant and transaction technology software and services enabling financial institutions to process and use high performance exchange data with Smart Order Routing and other applications. HyperFeed was a publicly traded company, which became a subsidiary of PICO Holdings in 2003, when we acquired direct ownership of a majority voting interest.

PICO first invested in HyperFeed in 1995, and we built our shareholding through the purchase of common stock and provision of convertible debt financing. During 2002 and 2003, HyperFeed restructured its operations, culminating in the sale of its consolidated market data feed customers to Interactive Data Corporation for $8.5 million in October 2003.

Despite possessing potentially valuable technology, HyperFeed was unable to generate sufficient cash flow to finance its own operations. During 2006, PICO and HyperFeed negotiated a business combination with Exegy Incorporated ("Exegy"). On August 25, 2006, PICO, HyperFeed, and Exegy entered into an agreement, pursuant to which the common stock of HyperFeed owned by PICO would have been contributed to Exegy in exchange for Exegy's issuance to PICO of certain Exegy stock. However, in a letter dated November 7, 2006, Exegy informed PICO and HyperFeed that it was terminating the agreement. At this time, PICO and HyperFeed dispute Exegy's right to terminate the agreement and plan to vigorously defend their rights thereunder through all available legal means.

Given the uncertainty of additional funding available to HyperFeed due to the termination of the agreement and therefore for HyperFeed to continue as a going concern, HyperFeed filed for bankruptcy protection under Chapter 7 of the U.S. Bankruptcy Code on November 29, 2006. See Note 2 of Notes to Consolidated Financial Statements, "Discontinued Operations".

Employees

At December 31, 2006, PICO had 42 employees. A total of 7 employees were engaged in land and related mineral rights and water rights operations; 9 in water resource and storage operations; 3 in property and casualty insurance operations; 2 in medical professional liability operations; and 21 in business acquisitions & financing and holding company activities.

Executive Officers

The executive officers of PICO are as follows:

Name	Age	Position
Ronald Langley	62	Chairman of the Board, Director
John R. Hart	47	President, Chief Executive Officer and Director
Richard H. Sharpe	51	Chief Operating Officer
James F. Mosier	59	General Counsel and Secretary
Maxim C. W. Webb	45	

		Chief Financial Officer and Treasurer
W. Raymond Webb	45	Vice President, Investments
John T. Perri	37	Vice President, Controller

Mr. Langley has been Chairman of the Board of PICO since November 1996 and of Physicians since July 1995. Mr. Langley has been a Director of PICO since November 1996 and a Director of Physicians since 1993. Mr. Langley has been a Director of Jungfraubahn Holding AG since 2000.

Mr. Hart has been President and Chief Executive Officer of PICO since November 1996 and of Physicians since July 1995. Mr. Hart has been a Director of PICO since November 1996 and a Director of Physicians since 1993.

Mr. Sharpe has served as Chief Operating Officer of PICO since November 1996 and in various executive capacities since joining Physicians in 1977.

Mr. Mosier has served as General Counsel and Secretary of PICO since November 1996 and of Physicians since October 1984 and in various other executive capacities since joining Physicians in 1981.

Mr. Maxim Webb has been Chief Financial Officer and Treasurer of PICO since May 14, 2001. Mr. Webb served in various capacities with the Global Equity Corporation group of companies since 1993, including Vice President, Investments of Forbes Ceylon Limited from 1994 through 1996. Mr. Webb became an officer of Global Equity Corporation in November 1997 and Vice President, Investments of PICO on November 20, 1998.

Mr. Raymond Webb has been with the Company since August 1999 as Chief Investment Analyst and became Vice President, Investments in April 2003.

Mr. Perri has been Vice President, Controller of PICO since April 2003 and served in various capacities since joining the Company in 1998, including Financial Reporting Manager and Corporate Controller.

Table of Contents

ITEM 1A. RISK FACTORS

The following information sets forth factors that could cause our actual results to differ materially from those contained in forward-looking statements we have made in this Annual Report on Form 10-K and those we may make from time to time. You should carefully consider the following risks, together with other matters described in this Form 10-K or incorporated herein by reference in evaluating our business and prospects. If any of the following risks occurs, our business, financial condition or operating results could be harmed. In such case, the trading price of our securities could decline, in some cases significantly. The risks described below are not the only ones we face. Additional risks not presently known to us, or that we currently deem immaterial, may also impair our business operations.

Our future water revenues are uncertain and depend on a number of factors that may make our revenue streams and profitability volatile.

We engage in various water resource acquisition, management, development, and sale and lease activities. Accordingly, our future profitability will primarily be dependent on our ability to develop and sell or lease water and water rights. Our long-term profitability will be affected by various factors, including the timing of water resource acquisitions, regulatory approvals and permits associated with such acquisitions, transportation arrangements, and changing technology. We may also encounter unforeseen technical difficulties which could result in construction delays and cost increases with respect to our water resource and water storage development projects. Moreover, our profitability is significantly affected by changes in the market price of water. Future prices of water may fluctuate widely as demand is affected by climatic, demographic and technological factors. Additionally, to the extent that we possess junior or conditional water rights, during extreme climatic conditions, such as periods of low flow or drought, our water rights could be subordinated to superior water rights holders. Many of the factors described above are not within our control. One or more of these factors could impact the profitability of our water resources and cause our results of operations to be volatile.

Our water activities may become concentrated in a limited number of assets, making our growth and profitability vulnerable to fluctuations in local economies and governmental regulations.

In the future, we anticipate that a significant amount of Vidler's revenues and asset value will come from a limited number of assets, including our water resources in Nevada and Arizona and the Vidler Arizona Recharge Facility. Water resources in this region are scarce and we may not be successful in continuing to acquire and develop additional water assets. If we are unable to develop additional water assets, our revenues will be derived from a limited number of assets, primarily located in Arizona and Nevada. As a result of this concentration, our invested capital and results of operation will be vulnerable to fluctuations in local economies and governmental regulations.

Vidler's Arizona Recharge facility is one of the few private sector water storage sites in Arizona. To date, we have stored more than 100,000 acre feet at the facility for our own account. We have not stored any water on behalf of any customers, and have not as yet generated any revenue from the recharge facility. We believe that the best economic return on the asset will come from storing water in surplus years for sale in dry years; however we cannot assure you that we will ultimately be able sell the stored water at a price sufficient to provide an adequate return on the capital we have invested in the facility.

A subsidiary of Vidler's is constructing a pipeline approximately 35 miles long, to deliver water from Fish Springs Ranch to the northern valleys of Reno, Nevada. Vidler estimates that the total cost of the pipeline will be in the $78 million to $83 million range, and completion is estimated to be late 2007 or early 2008. To date, Vidler has only entered into sale agreements for a very small proportion of the total amount of water that will be conveyed through the pipeline to the northern valleys of Reno. By the time construction of the pipeline has been completed, we anticipate that negotiations will have begun with the principal buyers of this water, who will largely be real estate developers. Although the current market value of water in the area greatly exceeds the total estimated cost of the pipeline and the water to be supplied, we cannot assure you that the sales prices we obtain will provide an adequate return on capital employed in the project. Furthermore, if our negotiations do not result in prices that are acceptable to us, we may choose to monetize the water at a later time, which would have an adverse effect on our near-term revenues and cash flows.

Table of Contents

Our water sales may meet with political opposition in certain locations, thereby limiting our growth in these areas.

The water rights we hold and the transferability of these rights to other uses and places of use are governed by the laws concerning the laws concerning water rights in the states of Arizona, California, and Nevada. Our sale of water resources is subject to the risks of delay associated with receiving all necessary regulatory approvals and permits. Additionally, the transfer of water rights from one use to another may affect the economic base of a community and will, in some instances, be met with local opposition. Moreover, certain of the end users of our water rights, namely municipalities, regulate the use of water in order to manage growth, thereby creating additional requirements that we must satisfy to sell and convey water resources. If we are unable to effectively sell and convey water rights, our liquidity will suffer and our revenues would decline.

The fair values of our real estate and water assets are linked to external growth factors.

The real estate and water assets we hold have fair values that are significantly affected by the growth in population and the general state of the local economies where our real estate and water assets are located, primarily in the states of Arizona and Nevada.

The current decline in the U.S. housing market, including the housing markets in Arizona and Nevada, may lead to a near-term slowdown in demand for our real estate and water assets, which could cause a decline in our revenues and income. While we do not expect long-term demand for our assets to decline, a slowdown in the housing market may impact the timing of our monetization of our real estate and water assets. Any prolonged delay in the monetization of our assets may have an adverse effect on our business, financial condition, results of operations, and cash flows.

Variances in physical availability of water, along with environmental and legal restrictions and legal impediments, could impact profitability from our water rights.

We value our water assets, in part, based upon the amounts of acre-feet of water we anticipate from water rights applications and permitted rights. The water rights held by us and the transferability of these rights to other uses and places of use are governed by the laws concerning water rights in the states of Arizona, Colorado and Nevada. The volumes of water actually derived from the water rights applications or permitted rights may vary considerably based upon physical availability and may be further limited by applicable legal restrictions. As a result, the amounts of acre-feet anticipated from the water rights applications or permitted rights do not in every case represent a reliable, firm annual yield of water, but in some cases describe the face amount of the water right claims or management's best estimate of such entitlement. Additionally, we may face legal restrictions on the sale or transfer of some of our water rights, which may affect their commercial value. If we were unable to transfer or sell our water rights, we may lose some or all of our value in our water rights acquisitions.

We may not receive all of the permitted water rights we expect from the water rights applications we have filed in Nevada.

We have filed certain water rights applications in Nevada, primarily as part of the water teaming agreement with Lincoln County. Vidler expends the capital required to enable the filed applications to be converted into permitted water rights. We only expend capital in those areas where our initial investigations lead us to believe that we can obtain a sufficient quantity of water to provide an adequate return on the capital employed in the project. These capital expenditures largely consist of drilling and engineering costs for water production, costs of monitoring wells, and legal and consulting costs for hearings with the State Engineer, and National Environmental Protection Act, or "NEPA", compliance costs. Until the State Engineer permits the water rights, there can be no assurance that we will be awarded all of the water which we expect based on the results of our drilling and our legal position. Any significant reduction in the quantity of water awarded to us from our expectations could adversely affect our revenues, profitability, and cash flows.

Our sale of water may be subject to environmental regulations which would impact the profitability of such sales.

The quality of the water we lease or sell may be subject to regulation by the United States Environmental Protection Agency acting pursuant to the federal Safe Drinking Water Act. While environmental regulations do not directly affect us, the regulations regarding the quality of water distributed affects our intended customers and may, therefore, depending on the quality of our water, impact the price and terms upon which we may in the future sell our water rights. If we need to reduce the price of our water rights in order to make a sale to our intended customers, our results of operations could suffer.

Table of Contents

Purchasers of our real estate and water assets may default on their obligations to us and adversely affect our results of operations and cash flow.

In certain circumstances, we finance sales of real estate and water assets, and we secure such financing through deeds of trust on the property, which are only released once the financing has been fully paid off. Purchasers of our real estate and water assets may default on their financing obligations. Such defaults may have an adverse effect on our business, financial condition, and the results of operations and cash flows.

If we do not successfully locate, select and manage acquisitions and investments, or if our acquisitions or investments otherwise fail or decline in value, our financial condition could suffer.

We invest in businesses that we believe are undervalued or that will benefit from additional capital, restructuring of operations or improved competitiveness through operational efficiencies. If a business in which we invest fails or its fair value declines, we could experience a material adverse effect on our business, financial condition, the results of operations and cash flows. Additionally, we may not be able to find sufficient opportunities to make our business strategy successful. Our failure to successfully locate, select and manage acquisition and investment opportunities could have a material adverse effect on our business, financial condition, the results of operations and cash flows. Such business failures, declines in fair values, and/or failure to successfully locate, select and manage acquisitions or investments could result in an inferior return on shareholders' equity. We could also lose part or all of our capital in these businesses and experience reductions in our net income, cash flows, assets and shareholders' equity.

Failure to successfully manage newly acquired companies could adversely affect our business.

Our management of the operations of acquired businesses requires significant efforts, including the coordination of information technologies, research and development, sales and marketing, operations, and finance. These efforts result in additional expenses and involve significant amounts of our management's time and could distract our management from the day-to-day operations of our business. The diversion of our management's attention from the day-to-day operations, or difficulties encountered in the integration process, could have a material adverse effect on our business, financial condition, and the results of operations and cash flows. If we fail to integrate acquired businesses into our operations successfully, we may be unable to achieve our strategic goals and the value of your investment could suffer.

Our acquisitions may result in dilution to our shareholders and increase liabilities.

We make selective acquisitions of companies that we believe could benefit from our resources of additional capital, business expertise or existing operations. We endeavor to enhance and realize additional value to these acquired companies through our influence and control. Any acquisition could result in the use of a significant portion of our available cash, significant dilution to you, and significant acquisition-related charges. Acquisitions may also result in the assumption of liabilities, including liabilities that are unknown or not fully known to us at the time of the acquisition, which could have a material adverse effect on us.

Our acquisitions and investments may yield low or negative returns for an extended period of time, which could temporarily or permanently depress our return on shareholders' equity, and we may not realize the value of the funds we invest.

We generally make acquisitions and investments that tend to be long term in nature, and for the purpose of realizing additional value by means of appropriate levels of shareholder influence and control. We acquire businesses that we believe to be undervalued or may benefit from additional capital, restructuring of operations or management or improved competitiveness through operational efficiencies with our existing operations. We may not be able to develop acceptable revenue streams and investment returns through the businesses we acquire, and as a result we may lose part or all of our investment in these assets. Additionally, when any of our acquisitions do not achieve acceptable rates of return or we do not realize the value of the funds invested, we may write down the value of such acquisitions or sell the acquired businesses at a loss. Some of our prior acquisitions have lost either part or all of the capital we invested. Unsuccessful acquisitions could have negative impacts on our cash flows, income, assets and shareholders' equity, which may be temporary or permanent. Moreover, the process we employ to enhance value in our acquisitions and investments can consume considerable amounts of time and resources. Consequently, costs incurred as a result of these acquisitions and investments may exceed their revenues and/or increases in their values for an extended period of time. Ultimately, however, we may not be able to develop the potential of these assets that we originally anticipated.

Our ability to achieve an acceptable rate of return on any particular investment is subject to a number of factors which may be beyond our control, including increased competition and loss of market share, quality of management, cyclical or uneven financial results, technological obsolescence, foreign currency risks and regulatory delays.

Table of Contents

We may not be able to sell our investments when it is advantageous to do so and we may have to sell these investments at a discount to fair value.

No active market exists for some of the companies in which we invest. We acquire stakes in private companies that are not as liquid as investments in public companies. Additionally, some of our acquisitions may be in restricted or unregistered stock of U.S. public companies. Moreover, even our investments for which there is an established market are subject to dramatic fluctuations in their market price. These illiquidity factors may affect our ability to divest some of our acquisitions and could affect the value that we receive for the sale of such investments and have a negative impact on our results of operations.

Our acquisitions of and investments in foreign companies subject us to additional market and liquidity risks which could affect the value of our stock.

We have acquired, and may continue to acquire, shares of stock in foreign public companies. Typically, these foreign companies are not registered with the SEC and regulation of these companies is under the jurisdiction of the relevant foreign country. The respective foreign regulatory regime may limit our ability to obtain timely and comprehensive financial information for the foreign companies in which we have invested. In addition, if a foreign company in which we invest were to take actions which could be deleterious to its shareholders, foreign legal systems may make it difficult or time-consuming for us to challenge such actions. These factors may affect our ability to acquire controlling stakes, or to dispose of our foreign investments, or to realize the full fair value of our foreign investments. In addition, investments in foreign countries may give rise to complex cross-border tax issues. We aim to manage our tax affairs efficiently, but given the complexity of dealing with domestic and foreign tax jurisdictions, we may have to pay tax in both the U.S. and in foreign countries, and we may be unable to offset any U.S. tax liabilities with foreign tax credits. If we are unable to manage our foreign tax issues efficiently, our financial condition and the results of operations and cash flows could be adversely affected. In addition, we are subject to foreign exchange risk through our acquisitions of stocks in foreign public companies. We attempt to mitigate this foreign exchange risk by borrowing funds in the same currency to purchase the stocks. Significant fluctuations in the foreign currencies in which we hold investments or consummate transactions, could negatively impact our financial condition and the results of operations and cash flows.

Volatile fluctuations in our insurance reserves could cause our financial condition to be materially misstated.

Although we provide reserves that management believes are adequate, the actual losses could be greater. Our insurance subsidiaries may not have established reserves that are adequate to meet the ultimate cost of losses arising from claims. It has been, and will continue to be, necessary for our insurance subsidiaries to review and make appropriate adjustments to reserves for claims and expenses for settling claims. Inadequate reserves could cause our financial condition to fluctuate from period to period and cause our financial condition to appear to be better than it actually is for periods in which insurance claims reserves are understated. In subsequent periods when we discover the underestimation and pay the additional claims, our cash needs will be greater than expected and our financial results of operations for that period will be worse than they would have been had our reserves been accurately estimated originally.

The inherent uncertainties in estimating loss reserves are greater for some insurance products than for others, and are dependent on various factors including:

- the length of time in reporting claims;
- the diversity of historical losses among claims;
- the amount of historical information available during the estimation process;
- the degree of impact that changing regulations and legal precedents may have on open claims; and
- the consistency of reinsurance programs over time.

Because medical malpractice liability, commercial property and casualty, and workers' compensation claims may not be completely paid off for several years, estimating reserves for these types of claims can be more uncertain than estimating reserves for other types of insurance. As a result, precise reserve estimates cannot be made for several years following the year for which reserves were initially established. During the past several years, the levels of the reserves for our insurance subsidiaries have been very volatile. We have had to significantly increase and decrease these reserves in the past several years. Significant increases in the reserves may be necessary in the future, and the level of reserves for our insurance subsidiaries may be volatile in the future. These increases or volatility may have an adverse effect on our business, financial condition, and the results of operations and cash flows.

If we underestimate the amount of reinsurance we need or if the companies with which we have reinsurance agreements default on their obligations, we may be unable to cover claims made and that would have a material adverse effect on our results of operations.

We have reinsurance agreements on all of our insurance books of business with reinsurance companies. We purchase reinsurance based upon our assessment of the overall direct underwriting risk. It is possible that we may underestimate the amount of reinsurance required to achieve the desired level of net claims risk, and a claim may exceed the combined value of our reserve and the amount of reinsurance available. Additionally, our reinsurers could default on amounts owed to us for their portion of the direct insurance claim. Our insurance subsidiaries, as direct writers of lines of insurance, have ultimate responsibility for the payment of claims, and any defaults by reinsurers may result in our established reserves not being adequate to meet the ultimate cost of losses arising from claims. If claims made exceed the amount of our direct reserves and the available reinsurance, we may be subject to regulatory action or litigation and our results of operation would suffer as a result.

Table of Contents

State regulators could require changes to our capitalization and/or to the operations of our insurance subsidiaries, and/or place them into rehabilitation or liquidation.

Beginning in 1994, Physicians and Citation became subject to the provisions of the Risk-Based Capital for Insurers Model Act which has been adopted by the National Association of Insurance Commissioners for the purpose of helping regulators identify insurers that may be in financial difficulty. The Model Act contains a formula which takes into account asset risk, credit risk, underwriting risk and all other relevant risks. Under this formula, each insurer is required to report to regulators using formulas which measure the quality of its capital and the relationship of its modified capital base to the level of risk assumed in specific aspects of its operations. The formula does not address all of the risks associated with the operations of an insurer. The formula is intended to provide a minimum threshold measure of capital adequacy by an individual insurance company and does not purport to compute a target level of capital. Companies which fall below the threshold will be placed into one of four categories: Company Action Level, where the insurer must submit a plan of corrective action; Regulatory Action Level, where the insurer must submit such a plan of corrective action, the regulator is required to perform such examination or analysis the Superintendent of Insurance considers necessary and the regulator must issue a corrective order; Authorized Control Level, which includes the above actions and may include rehabilitation or liquidation; and Mandatory Control Level, where the regulator must rehabilitate or liquidate the insurer. As of December 31, 2006, all of our insurance subsidiaries' risk-based capital results exceeded the Company Action Level. However, we cannot assure you that insurance subsidiaries' risk-based capital results will exceed the Company Action Level in the future. If the risk-based capital of any of our insurance subsidiaries fails to exceed the Company Action Level, we will be subject to the regulatory action described above and our results of operations could suffer.

If we are required to register as an investment company, we will be subject to a significant regulatory burden and our results of operations will suffer.

At all times we intend to conduct our business so as to avoid being regulated as an investment company under the Investment Company Act of 1940. However, if we were required to register as an investment company, our ability to use debt would be substantially reduced, and we would be subject to significant additional disclosure obligations and restrictions on our operational activities. Because of the additional requirements imposed on an investment company with regard to the distribution of earnings, operational activities and the use of debt, in addition to increased expenditures due to additional reporting responsibilities, our cash available for investments would be reduced. The additional expenses would reduce income. These factors would adversely affect our business, financial condition, and the results of operations and cash flows.

We are directly impacted by international affairs, which directly exposes us to the adverse effects of any foreign economic or governmental instability.

As a result of global investment diversification, our business, financial condition, the results of operations and cash flows may be adversely affected by:

- exposure to fluctuations in exchange rates;
- the imposition of governmental controls;
- the need to comply with a wide variety of foreign and U.S. export laws;
- political and economic instability;
- trade restrictions;
- changes in tariffs and taxes;
- volatile interest rates;
- changes in certain commodity prices;
- exchange controls which may limit our ability to withdraw money;
- the greater difficulty of administering business overseas; and

· general economic conditions outside the United States.

Changes in any or all of these factors could result in reduced market values of investments, loss of assets, additional expenses, reduced investment income, reductions in shareholders' equity due to foreign currency fluctuations and a reduction in our global diversification.

Table of Contents

Because our operations are diverse, analysts and investors may not be able to evaluate us adequately, which may negatively influence our share price.

PICO is a diversified holding company with operations in real estate and related water rights and mineral rights; water resource development and water storage; insurance operations in run-off; and business acquisitions and financing. Each of these areas is unique, complex in nature, and difficult to understand. In particular, the water resource business is a developing industry within the western United States with very little historical data, very few experts and a limited following of analysts. Because we are complex, analysts and investors may not be able to adequately evaluate our operations and PICO in total. This could cause analysts and investors to make inaccurate evaluations of our stock, or to overlook PICO in general. As a result, the trading volume and price of our stock could suffer.

Fluctuations in the market price of our common stock may affect your ability to sell your shares.

The trading price of our common stock has historically been, and we expect to continue to be, subject to fluctuations. The market price of our common stock may be significantly impacted by:

- quarterly variations in financial performance and condition;
- shortfalls in revenue or earnings from levels forecast by securities analysts;
- changes in estimates by such analysts;
- product introductions;
- our competitors' announcements of extraordinary events such as acquisitions;
- litigation; and
- general economic conditions.

Our results of operations have been subject to significant fluctuations, particularly on a quarterly basis, and our future results of operations could fluctuate significantly from quarter to quarter and from year to year. Causes of such fluctuations may include the inclusion or exclusion of operating earnings from newly acquired or sold operations. At December 31, 2006, the closing price of our common stock on the NASDAQ Global Market was $34.77 per share, compared to $20.77 at December 31, 2004. On a quarterly basis between these two dates, closing prices have ranged from a high of $35.53 to a low of $20.93. Statements or changes in opinions, ratings, or earnings estimates made by brokerage firms or industry analysts relating to the markets in which we do business or relating to us specifically could result in an immediate and adverse effect on the market price of our common stock. Such fluctuations in the market price of our common stock could affect the value of your investment and your ability to sell your shares.

We may not be able to retain key management personnel we need to succeed, which could adversely affect our ability to successfully operate our businesses.

To run our day-to-day operations and to successfully manage newly acquired companies we must, among other things, continue to attract and retain key management. We rely on the services of several key executive officers. If they depart, it could have a significant adverse effect. Messrs. Langley and Hart, our Chairman and CEO, respectively, are key to the implementation of our strategic focus, and our ability to successfully develop our current strategy is dependent upon our ability to retain the services of Messrs. Langley and Hart.

We use estimates and assumptions in preparing financial statements in accordance with accounting principles generally accepted in the United States of America.

The preparation of our financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent liabilities at the date of financial statements and the reported amount of revenues and expenses during the reporting period. We regularly evaluate our estimates, which are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. The result of these evaluations forms the basis for our judgments about the carrying values of assets and liabilities and the reported amount of revenues and expenses that are not readily apparent from other sources. The carrying values of assets and liabilities and the reported amount of revenues and expenses may differ by using different assumptions. In addition, in future periods, in order to incorporate all known experience at that time, we may have to revise assumptions previously made which may change the value of previously reported assets and liabilities. This potential subsequent change in value may have a material adverse effect on our business, financial condition, and the results of operations and cash flows.

Repurchases of our common stock could have a negative effect on our cash flows and our stock price.

Our Board of Directors has authorized the repurchase of up to $10 million of our common stock. The stock purchases may be made from time to time at prevailing prices though open market, or negotiated transactions, depending on market conditions, and will be funded from available cash resources of the company. Such repurchases may have a negative impact on our cash flows, and could result in market pressure to sell our common stock.

Table of Contents

Future changes in financial accounting standards may cause adverse unexpected revenue fluctuations and affect our reported results of operations.

A change in accounting standards could have a significant effect on our reported results and may even affect our reporting transactions completed before the change is effective. New accounting pronouncements and varying interpretations of pronouncements have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, SEC regulations and NASDAQ Stock Market rules, are creating uncertainty for companies such as ours. These new or changed laws, regulations and standards are subject to varying interpretations in many cases due to their lack of specificity, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. In particular, our efforts to maintain compliance with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding our required assessment of our internal controls over financial reporting and our external auditors' audit of that assessment has required the commitment of substantial financial and managerial resources. We expect these efforts to require the continued commitment of significant resources. Further, our board members, chief executive officer, and chief financial officer could face an increased risk of personal liability in connection with the performance of their duties and we may be required to indemnify them for any expenses incurred in defending against claims. As a result, we may have difficulty attracting and retaining qualified board members and executive officers, which could harm our business. If our efforts to comply with new or changes laws, regulations, and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, our reputation could be harmed.

Absence of dividends could reduce our attractiveness to investors.

Some investors favor companies that pay dividends, particularly in market downturns. We have never declared or paid any cash dividends on our common stock. We currently intend to retain any future earnings for funding growth and, therefore, we do not currently anticipate paying cash dividends on our common stock.

We may need additional capital in the future to fund the growth of our business, and financing may not be available.

We currently anticipate that our available capital resources and operating income will be sufficient to meet our expected working capital and capital expenditure requirements for at least the next 12 months. However, we cannot assure you that such resources will be sufficient to fund the long-term growth of our business. We may raise additional funds through public or private debt or equity financings if such financings become available on favorable terms, but such financing may dilute the interests of our stockholders. We cannot assure you that any additional financing we need will be available on terms favorable to us, or at all. If adequate funds are not available or are not available on acceptable terms, we may not be able to take advantage of unanticipated opportunities or otherwise respond to competitive pressures. In any such case, our business, operating results or financial condition could be materially adversely affected.

Litigation may harm our business or otherwise distract our management.

Substantial, complex or extended litigation could cause us to incur large expenditures and distract our management. For example, lawsuits by employees, stockholders or customers could be very costly and substantially disrupt our business. Additionally, our subsidiaries may become involved in litigation that could necessitate our management's attention and require us to expend our resources. We or our subsidiaries will have disputes from time to time with companies or individuals, and we cannot assure that that we will always be able to resolve such disputes out of court or on terms favorable to us.

THE FOREGOING FACTORS, INDIVIDUALLY OR IN AGGREGATE, COULD MATERIALLY ADVERSELY AFFECT OUR OPERATING RESULTS AND CASH FLOWS AND FINANCIAL CONDITION AND COULD MAKE COMPARISON OF HISTORIC OPERATING RESULTS AND CASH FLOWS AND BALANCES DIFFICULT OR NOT MEANINGFUL.

__Table of Contents__

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

PICO leases approximately 6,354 square feet in La Jolla, California for its principal executive offices.

Physicians leases approximately 1,892 square feet of office space in Columbus, Ohio for its headquarters. Citation leases office space for a claims office in Orange County, California. Vidler and Nevada Land lease office space in Carson City, Nevada. Vidler and Nevada Land hold significant investments in real estate and water assets and mineral rights in the southwestern United States. We continually evaluate our current and future space capacity in relation to our business needs. We believe that our existing facilities are suitable and adequate to meet our current business requirements. *See "Item 1-Business-Introduction."*

ITEM 3. LEGAL PROCEEDINGS

The Company is subject to various litigation that arises in the ordinary course of its business. Members of PICO's insurance group are frequently a party in claims proceedings and actions regarding insurance coverage, all of which PICO considers routine and incidental to its business. Based upon information presently available, management is of the opinion that such litigation will not have a material adverse effect on the consolidated financial position, the results of operations or cash flows of the Company.

Neither PICO nor its subsidiaries are parties to any potentially material pending legal proceedings other than the following.

Exegy Litigation:

On November 7, 2006 Exegy Incorporated ("Exegy") sent letters to PICO Holdings, Inc. ("PICO") and HyperFeed Technologies, Inc. (HyperFeed"), purporting to terminate the August 25, 2006 agreement among PICO, HyperFeed, and Exegy. The agreement contemplated a transaction between the parties whereby the common stock of HyperFeed owned by PICO would have been contributed to Exegy in exchange for Exegy's issuance to PICO of certain Exegy stock.

On November 13, 2006 Exegy filed a lawsuit against PICO and HyperFeed in state court in Missouri seeking a declaratory judgment that Exegy's purported November 7, 2006 termination of the August 25, 2006 agreement was valid. In the event that Exegy's November 7, 2006 letter is not determined to be a valid termination of the agreement, Exegy seeks a declaration that PICO and HyperFeed have materially breached the agreement, for which Exegy seeks monetary damages and an injunction against further material breach. Finally, Exegy seeks a declaratory judgment that if its November 7, 2006 notice of termination was not valid, and that if PICO and HyperFeed did materially breach the agreement but that a continuing breach cannot be remedied or enjoined, then Exegy seeks a declaration that Exegy should be relieved of further performance under the agreement due to alleged HyperFeed actions deemed by Exegy to be inconsistent with the agreement. On December 15, 2006 the lawsuit filed by Exegy on November 13, 2006 was removed from Missouri state court to federal court.

On November 17, 2006 HyperFeed and PICO filed a lawsuit against Exegy in state court in Illinois. PICO and HyperFeed allege that Exegy, after the November 7, 2006 letter purporting to terminate the agreement, used and continues to use HyperFeed's confidential and proprietary information in an unauthorized manner and without HyperFeed's consent. PICO and HyperFeed are also seeking a preliminary injunction enjoining Exegy from disclosing, using, or disseminating HyperFeed's confidential and proprietary information, and from continuing to interfere with HyperFeed's business relations. PICO and HyperFeed also seek monetary damages from Exegy. On January 18, 2007 this case was removed from Illinois state court to federal bankruptcy court in Illinois. On February 21, 2007 this case was transferred to the United States Bankruptcy Court, District of Delaware.

It is anticipated that the United States Bankruptcy Court, District of Delaware will accept the transfer of the case which is presently in federal court in Missouri, and consolidate the cases in HyperFeed's pending Chapter 7 bankruptcy action, where both cases will continue as adversary proceedings.

HyperFeed Technologies:

On November 29, 2006 HyperFeed, an 80%-owned subsidiary of PICO, filed a voluntary petition for relief under Chapter 7 of the United States Bankruptcy Code captioned In Re Hyperfeed Technologies, Inc., filed in the United States District Court for the District of Delaware, Case No. 06-11357 (CSS). On November 30, 2006, the bankruptcy court appointed the Chapter 7 Trustee of Hyperfeed's bankruptcy estate. Hyperfeed is indebted to PICO pursuant to a Secured Convertible Promissory Note dated March 30, 2006, in the original principal amount of $10 million. PICO asserts it is the largest creditor and interest holder in the bankruptcy case. The Trustee in presently investigating PICO's claims and security position.

Fish Springs Ranch, LLC:

The final regulatory approval required for the Fish Springs pipeline project is a Record of Decision ("ROD") for a right of way, which was granted on May 31, 2006. Subsequently, there were two protests against the ROD, and the matter was appealed to the Interior Board of Land Appeals ("IBLA"). During the third quarter of 2006, the IBLA refused to stay the ROD.

However, in October 2006, one protestant filed an action with the U.S. District Court against the Bureau of Land Management ("BLM") and the U.S. Department of the Interior. The complaint is identical to the appeal dismissed by the IBLA. On December 13, 2006 the Federal District Court refused to issue a temporary restraining order. On February 26, 2007, after oral argument, the Federal District Court took under submission the protestant's request for a preliminary injunction. A ruling on the motion is expected during the first or second quarter of 2007. The Company believes that the protestant's latest legal action to obtain a preliminary injunction in Federal District Court is likely to fail. Although the Company is not currently a party to the proceedings, we will continue to participate in the case, as allowed bv the Federal District Court, to protect our interest in the pipeline project.

Table of Contents

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted during the fourth quarter of 2006 to a vote of the Company’s shareholders, through the solicitation of proxies or otherwise.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The common stock of PICO is traded on the NASDAQ Global Market under the symbol “PICO.” The following table sets out the high and low daily closing sale prices as reported on the NASDAQ Global Market. These reported prices reflect inter-dealer prices without adjustments for retail markups, markdowns or commissions.

	2006		2005	
	High	Low	High	Low
1st Quarter	$ 35.37	$ 31.59	$ 27.00	$ 20.93
2nd Quarter	$ 35.03	$ 30.05	$ 29.76	$ 23.94
3rd Quarter	$ 35.53	$ 29.72	$ 35.14	$ 28.41
4th Quarter	$ 34.91	$ 30.42	$ 35.35	$ 32.12

On March 8, 2007, the closing sale price of PICO’s common stock was $37.68 and there were approximately 627 holders of record.

PICO has not declared or paid any dividends in the last two years, and does not expect to pay any dividends in the foreseeable future.

Securities Authorized for Issuance Under Equity Compensation Plans

The information required by Item 201(d) of Regulation S-K is provided under Item 12, *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters,*“Securities Authorized for Issuance Under Equity Compensation Plans,” which is incorporated herein by reference.

Company Stock Performance Graph

Set forth below is a graph comparing the total return on an indexed basis of a $100 investment in the Company's stock, Standard's and Poor's 500 Index and the Russel 200 Index. The measurement points utilized in the graph consists of the last trading day in each calendar year, which closely approximates the last day of the respective fiscal year of the Company. The historical stock performance presented below is not intended to and may not be indicative of future stock performance.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total number of shares purchased	(b) Average Price Paid per Share	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (1)	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1)
10/1/06 - 10/31/06	-	-		
11/1/06 - 11/30/06	-	-		
12/1/06 - 12/31/06	-	-		

(1) In October 2002, PICO's Board of Directors authorized the repurchase of up to $10 million of PICO common stock. The stock purchases may be made from time to time at prevailing prices through open market or negotiated transactions, depending on market conditions, and will be funded from available cash. As of December 31, 2006, no stock had been repurchased under this authorization.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA

The following table presents the Company's selected consolidated financial data. The information set forth below is not necessarily indicative of the results of future operations and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this Form 10-K and the consolidated financial statements and the related notes thereto included elsewhere in this document.

The following selected financial data for the years ended December 31, 2005 through December 31, 2002 differ from previously reported selected financial data due to reporting the results of HyperFeed as discontinued operations. This information is derived from the statement of operations. See also Note 2, "Discontinued Operations" of Notes to Consolidated Financial Statements.

	Year Ended December 31,				
	2006	2005	2004	2003	2002
OPERATING RESULTS	(In thousands, except share data)				
Revenues:					
Total investment income	$ 39,609	$ 15,917	$ 9,056	$ 8,100	9,595
Sale of real estate and water assets	41,509	124,984	10,879	19,751	15,232
Other income	1,605	1,210	2,188	3,648	4,447
Total revenues	$ 82,723	$ 142,111	$ 22,123	$ 31,499	$ 29,274
Income (loss) from continuing operations	$ 31,511	$ 22,267	$ (7,860)	$ (5,982)	$ 2,568
Income (loss) from discontinued operations, net	(2,268)	(6,065)	(2,698)	2,744	1,376
Cumulative effect of change in accounting principle, net					1,985
Net income (loss)	$ 29,243	$ 16,202	$ (10,558)	$ (3,238)	$ 5,929
<u>PER COMMON SHARE BASIC AND DILUTED:</u>					
Income (loss) from continuing operations	$ 2.10	$ 1.72	$ (0.64)	$ (0.48)	$ 0.21
Income (loss) from discontinued operations	(0.15)	(0.47)	(0.22)	0.22	0.11
Cumulative effect of change in accounting principle					0.16
Net income (loss)	$ 1.95	$ 1.25	$ (0.85)	$ (0.26)	$ 0.48
Weighted Average Shares Outstanding	14,994,947	12,959,029	12,368,068	12,375,933	12,375,466

	Year Ended December 31,				
	2006	2005	2004	2003	2002
<u>FINANCIAL CONDITION</u>	(In thousands, except per share data)				
Assets	$ 549,043	$ 441,830	$ 354,658	$ 330,937	$ 2655,87
Asset of discontinued operations		$ 4,616	3,974	9,864	498
Unpaid losses and loss adjustment expenses	$ 41,083	$ 46,647	$ 55,944	$ 60,864	$ 52,703
Bank borrowings	$ 12,721	$ 11,835	$ 17,556	$ 15,377	$ 14,636

Liabilities of discontinued operations			$	4,282	$	3,121	$	3,784		
Total liabilities and minority interest	$	143,816	$	140,955	$	114,729		101,777	$	81,888
Shareholders' equity	$	405,227	$	300,875	$	239,929	$	229,160	$	221,032
Book value per share (1)	$	25.52	$	22.67	$	19.40	$	18.52	$	17.86

(1) Book value per share is computed by dividing shareholders' equity by the net of total shares issued less shares held as treasury shares.

Table of Contents

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION

The consolidated financial statements and other portions of this Annual Report on Form 10-K for the fiscal year ended December 31, 2006, including Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," reflect the effects of presenting HyperFeed Technologies, Inc. as a discontinued operation.See Note 2 of Notes to Consolidated Financial Statements, "Discontinued Operations".

COMPANY SUMMARY, RECENT DEVELOPMENTS AND FUTURE OUTLOOK

WATER RESOURCE AND WATER STORAGE OPERATIONS

BACKGROUND

We believe that continuing trends in Nevada and Arizona indicate strong future demand for Vidler's water rights and water storage assets.

Based on figures published by the Nevada State Demographer, in the six years from 2000 to 2006, the population of Clark County, Nevada, which includes metropolitan Las Vegas, increased 34.4% to almost 1.9 million residents. Around 70,000 people are moving to the area annually. Currently Las Vegas takes most of its water supply from Lake Mead, which is primarily fed by water flows from the Colorado River. Due to the continued growth in demand for water and a prolonged drought, the level of Lake Mead is close to 50 year lows. Accordingly, Las Vegas is aggressively seeking to conserve water (e.g., rules have been introduced restricting water use in new homes) and to diversify its sources of water supply. At the same time, the increasing cost of housing in Las Vegas is leading to more rapid growth in outlying areas within commuting distance.

We believe that over time, these factors will lead to demand for water in parts of southern Nevada where Vidler owns or has an interest in water rights, including southern Lincoln County, Sandy Valley, and Moapa Valley (Muddy River) in Clark County. If growth management initiatives are introduced in Las Vegas, we believe this will lead to even more rapid growth in the areas surrounding metropolitan Las Vegas.

Due to the low level of Lake Mead, the lower basin states of Arizona, California, and Nevada may be required to take no more than their current allotments of water from the Colorado River. This is likely to increase demand for the net recharge credits owned by Vidler, representing water which Vidler has in storage in its Arizona Recharge Facility. We also anticipate demand from developers and other entities to store water for various purposes, including developers who need a back-up water supply for dry years and an assured water supply for new development projects.

The Central Arizona Water Conservation District ("CAWCD") is a three-county water district servicing the most populous parts of Arizona, including Maricopa County. A 2003 CAWCD study predicted that CAWCD will be able to use 9 million acre-feet of water from Arizona's Colorado River supplies in the years from 2004 through 2050, assuming average annual precipitation. The CAWCD also estimated that 8.6 million acre-feet will be required over the same period by the Central Arizona Groundwater Replenishment District, the authority responsible for protecting groundwater supplies in the CAWCD three-county service area. The CAWCD also estimated demand of 3.5 million acre-feet from the Arizona Water Bank for various purposes (e.g., use in Nevada), and a further 4.3 million acre-feet to replenish groundwater reserves. Based on these forecasts, Arizona appears to be faced with a shortfall of 7.4 million acre-feet of water in the period through 2050, which will require CAWCD to acquire additional supplies.

In 2006, the Southern Nevada Water Authority released an updated water resource plan (which can be viewed at www.snwa.com) to develop and deliver water supplies to meet regional growth demands. This plan consists of (1) the storage of water, including up to 1.25 million acre-feet in Arizona, combined with (2) the development of further water resources in Nevada. We believe that Vidler's assets are well positioned to contribute to the water resource solutions required in Nevada.

Table of Contents

WATER RESOURCES

Arizona

Any new residential development in Arizona must obtain a permit from the Arizona Department of Water Resources certifying a "designated assured water supply" sufficient to sustain the development for at least 100 years. Harquahala Valley ground water meets the designation of assured water supply, but in order to be used by municipalities in the heavily populated parts of Arizona, the water must be transported from the Harquahala Valley to the end users. Arizona state legislation allows Harquahala Valley ground water to be made available as assured water supply to cities and communities in Arizona through agreements with the Central Arizona Groundwater Replenishment District.

At December 31, 2006, Vidler owned approximately 2,880 acre-feet of ground water and the related land in the Harquahala Valley. The Harquahala Valley is located in La Paz County and Maricopa County, approximately 75 miles northwest of metropolitan Phoenix, Arizona. According to U.S. Census Bureau data, the population of Maricopa County increased 18.3% from 2000 to 2005, with the addition of more than 110,000 people per year. Vidler anticipates that as the boundaries of the greater Phoenix metropolitan area push out, this is likely to lead to demand for water to support growth within the Harquahala Valley itself. The remaining water can also be transferred for municipal use outside of the Harquahala Valley.

Nevada

Vidler has acquired water rights in northern Nevada through the purchase of ranch properties (i.e., appropriating existing supplies of water), filing applications for new water rights (i.e., appropriating new supplies of water), and entering into teaming arrangements with parties owning water rights, which they wish to maximize the value of.

In 19 of the past 20 years, Nevada was the state which experienced the most rapid population growth and new home construction in the United States, and in 2006 it was second, behind Arizona. The population is concentrated in southern Nevada, which includes the Las Vegas metropolitan area.

1. Lincoln County

The Lincoln County Water District and Vidler ("Lincoln/Vidler") have entered into a water delivery teaming agreement to locate and develop water resources in Lincoln County, Nevada.   Under the agreement proceeds from sales of water will be shared equally after Vidler is reimbursed for the expenses incurred in developing water resources in Lincoln County. Lincoln/Vidler has filed applications for more than 100,000 acre-feet of water rights with the intention of supplying water for residential, commercial, and industrial use, as contemplated by the County's approved master plan. We believe that this is the only known new source of water for Lincoln County. Vidler anticipates that up to 40,000 acre-feet of water rights will ultimately be permitted from these applications, and put to use for projects in Lincoln County.

Under the Lincoln County Land Act, more than 13,300 acres of federal land in southern Lincoln County near the fast growing City of Mesquite was offered for sale in February 2005. According to press reports, the eight parcels offered sold to various developers for approximately $47.5 million. The land was sold without environmental approvals, water, and city services, which will be required before development can proceed. Additional water supply will be required in Lincoln County if this land is to be developed.

Tule Desert Groundwater Basin
In 1998, Lincoln/Vidler filed for 14,000 acre-feet of water rights for industrial use from the Tule Desert Groundwater Basin. In November 2002, the Nevada State Engineer granted an application for 2,100 acre-feet of water rights, and

ruled that another 7,244 acre-feet could be granted, but would be held in abeyance while Lincoln/Vidler pursues additional studies.

Table of Contents

In 2005 Lincoln/Vidler entered into an agreement with a devloper. Tthe developer has up to 10 years to purchase up to 7,240 acre-feet of water, as and when supplies are permitted from the applications. We anticipate that the hearings to permit these applications will commence in 2007. During 2006, Vidler successfully drilled a series of production and monitoring wells to provide evidence to support the applications. The initial price of $7,500 per acre-foot will increase at 10% each year. In addition, the developer pays a commitment fee equal to 10% of the outstanding balance of unpurchased water each year, beginning August 9, 2006, which will be applied to the purchase of water.

The Lincoln County teaming arrangement is an example of a transaction where Vidler can partner with an entity, in this case a governmental entity, to provide the necessary capital, entrepreneurial skills, and technical expertise to commercially develop water assets, thereby providing a significant economic benefit to the partner.

Coyote Springs

Coyote Springs (www.coyotesprings.com) is a planned mixed-use development to be located approximately 40 miles north of Las Vegas, at the junction of U.S. Highway 93 and State Highway 168, partially within Lincoln County, Nevada, and partially within Clark County, Nevada. Coyote Springs is the largest privately-held property for development in southern Nevada. The developer, Coyote Springs Investment, LLC ("CSIL"), has received entitlements for approximately 50,000 residential units, 6 golf courses, and 1,200 acres of retail and commercial development on 13,100 acres in Clark County. CSIL expects to receive additional entitlements for its 29,800 acres in Lincoln County. Based on the entitlements obtained so far, it is estimated that the community will require approximately 35,000 acre-feet of permanent water. Additional water will be required as further entitlements are obtained. It is expected that full absorption of the residential units will take 25 years or more.

Pardee Homes has agreed to be the master residential developer on the first phase of the development. Construction of the first golf course is expected to be finished in 2007, and CSIL has stated that the first houses should start going up in 2007.

In 2006, Lincoln/Vidler sold approximately 570 acre-feet of water rights at Meadow Valley, located in Lincoln and Clark counties, to CSIL for approximately $3.4 million, or $6,050 per acre-foot. Vidler's 50% share of the sales price was $1.7 million.

We anticipate that Lincoln County/Vidler could provide the majority of the water required for the Coyote Springs project from the jointly filed applications for water rights in various basins in Lincoln County.

In 2005, Lincoln/Vidler agreed to sell additional water to CSIL, as and when supplies are permitted from existing applications in Kane Springs, Nevada. The initial purchase price for the water was $6,050 per acre-foot for the first year of the agreement. The price of unpurchased water will increase 10% each year on the anniversary of the agreement, and is currently $6,655 per acre-foot.

A hearing was completed in 2006 on a filing for water rights from Kane Springs, and in January 2007 Lincoln/Vidler was awarded 1,000 acre-feet of permitted water rights. The Nevada State Engineer has requested additional data before making a determination on the balance of the applications from this groundwater basin, where Lincoln/Vidler maintains priority applications for approximately 17,375 acre-feet of water. The actual permits received may be for a lesser quantity, which cannot be accurately predicted.

Once the permit for the 1,000 acre-feet of water from Kane Springs has been received, the sale to CSIL is scheduled to close in 30 days.

Lincoln County Power Plant Project

In 2005, Vidler entered into an option agreement to sell its interest in a project to construct a new electricity-generating plant in southern Lincoln County, for $4.8 million. It is anticipated that the new plant will supply electricity to the new communities to be developed near Mesquite, and surrounding areas, which are expected to be fast-growing. If the purchaser exercises the option to purchase the interest in the power project, the agreement is scheduled to close in 2007. The purchaser has made all of the scheduled option exercise payments to date.

This project is 100% owned by Vidler, and does not form part of the Lincoln/Vidler teaming arrangement.

2. Fish Springs Ranch

Vidler has a 51% membership interest in, and is the managing partner of, Fish Springs Ranch, LLC ("Fish Springs"), and owns 100% of V&B, LLC. These companies own the Fish Springs Ranch and other properties totaling approximately 8,600 acres in Honey Lake Valley in Washoe County, 45 miles north of Reno, Nevada, and permitted water rights related to the properties, which are transferable to the Reno/Sparks area. The Fish Springs Ranch water rights have been identified as the most economical and proven new source of supply to support new growth in the north valley communities of Washoe County. According to the Nevada State Demographer, from 2000 to 2006, the population of Washoe County (including Reno/Sparks) increased by 19.6% to approximately 409,000 people.

Table of Contents

Residential property developers have publicly stated that Reno is constrained for land. If additional water can be supplied to Reno and the surrounding areas, this will allow the development of additional land. Indicative market prices for new water delivered to Reno have appreciated strongly, commensurate with increases in the value of raw land and finished homes. Given these market conditions, Fish Springs has determined that it would be advantageous to construct, at its own expense, a pipeline approximately 35 miles long, to convey 8,000 acre-feet of water annually from Fish Springs Ranch to a central storage tank in northern Reno, which could supply water to the new projects of several developers in the northern valleys.

The current market value of water in the area greatly exceeds the total estimated cost of the pipeline and the water to be supplied. To date, Vidler has entered into agreements to sell approximately 117.5 acre-feet of water at a price of $45,000 per acre-foot, as and when water can be delivered through the completed pipeline.

During 2006, we completed design of the pipeline project, and began construction of the pipeline and a plant to generate the electricity which will be required to pump the water. The total cost of the pipeline project is estimated to be in the $78 million to $83 million range. As of December 31, 2006, approximately $28.7 million of costs related to the design and construction of the pipeline have been capitalized (i.e., recorded as an asset in our balance sheet, in the line “Real estate and water assets”). The balance of the cost of the pipeline project will be outlaid over the next 6 to 12 months. As of March 2007, Vidler has commitments for future capital expenditures amounting to approximately $25.1 million, relating to the Fish Springs pipeline.

The final regulatory approval required for the pipeline project was a Record of Decision (“ROD”) for a right of way, which was granted on May 31, 2006. Subsequently, there were two protests against the ROD, and the matter was appealed to the Interior Board of Land Appeals (“IBLA”). During the third quarter of 2006, the IBLA refused to stay the ROD.

However, in October 2006, one protestant, the Pyramid Lake Tribe, filed an action with the U.S. District Court against the Bureau of Land Management (“BLM”) and the U.S. Department of the Interior. The complaint is identical to the appeal dismissed by the IBLA. On December 13, 2006 the Federal District Court refused to issue a temporary restraining order. On February 26, 2007, after oral argument, the Federal District Court took under submission the Tribe’s request for a preliminary injunction. A ruling on the motion is expected in the first or second quarter of 2007.

Vidler management believes that the Tribe’s latest legal action to obtain a preliminary injunction is also likely to fail. Although Vidler is not currently a party to the proceedings, Vidler will continue to participate in monitoring the case, as allowed by the Federal District Court to protect its interest in the pipeline project.

3. Carson City, Nevada

The capital city of Nevada, Carson City is located in the western part of the state, close to the border with California, and approximately 30 miles from Reno. The city limits cover approximately 146 square miles. The Nevada State Demographer estimated the population of Carson City at 57,701 on July 1, 2006, an increase of 8.4% over the past 6 years.

In December 2006, Carson City entered into a water resources teaming agreement with Vidler to develop water resources within the jurisdiction of Carson City. An important objective of the agreement is to improve, expand and develop existing production, treatment, storage, and reclamation activities, including a reclaimed water storage reservoir in the Brunswick Canyon in Carson City, which may result in additional water rights credits being granted. The agreement also contemplates the filing of applications for new water rights in areas containing Carson City water resources.

These water resource activities, both within and outside Carson City boundaries, are intended to facilitate new supplies of water that potentially could be used by fast-growing communities adjoining Carson City.

4. Sandy Valley, Nevada

In June 2002, the Nevada State Engineer awarded Vidler 415 acre-feet of water rights near Sandy Valley, Nevada. Vidler has filed another application for 1,000 acre-feet.

Table of Contents

The award of the permit for the 415 acre-feet of water rights was appealed, and is currently under reconsideration in the Nevada Supreme Court, which we believe is the final court of appeal for the matter. Once the appeal has been concluded, we anticipate utilizing the water rights to support future growth in Sandy Valley or surrounding areas in southwestern Nevada.

5. Muddy River water rights

The Muddy River is a perennial river fed by the Muddy Springs in southern Nevada, originating in Nevada and flowing into Lake Mead. Currently, Muddy River water rights are utilized for agriculture and electricity generation; however, in the future, we anticipate that Muddy River water rights may be utilized to support development in southern Nevada. The Southern Nevada Water Authority 2006 water resource plan identifies Muddy River water rights as a water resource to support future growth in Clark County, Nevada.

At December 31, 2006, Vidler owned approximately 221 acre-feet of Muddy River water rights, and had the right to acquire an additional 46 acre-feet.

Colorado

Vidler is completing the process of monetizing its water rights in Colorado, through sale or lease:

- in 2004, Vidler closed on the sale of approximately 6.5 acre-feet of water rights for $266,000;
- in 2005, Vidler closed on the sale of approximately 5.5 acre-feet of water rights for $261,000; and
- in 2006, Vidler closed on the sale of various water rights and related assets to the City of Golden, Colorado for $1.2 million.

Discussions are continuing to either lease or sell the remaining water rights in Colorado, which are listed in the table in the Vidler section of Item 1, "Business."

WATER STORAGE

1. Vidler Arizona Recharge Facility

During 2000, Vidler completed the second stage of construction at its facility to "bank," or store, water underground in the Harquahala Valley, and received the necessary permits to operate a full-scale water "recharge" facility. "Recharge" is the process of placing water into storage underground. Vidler has the permitted right to recharge 100,000 acre-feet of water per year at the Vidler Arizona Recharge Facility, and anticipates being able to store in excess of 1 million acre-feet of water in the aquifer underlying much of the valley. When needed, the water will be "recovered," or removed from storage, by ground water wells.

The Vidler Arizona Recharge Facility is the first privately owned water storage facility for the Colorado River system, which is a primary source of water for the Lower Division States of Arizona, California, and Nevada. The water storage facility is strategically located adjacent to the Central Arizona Project ("CAP") aqueduct, a conveyance canal running from Lake Havasu to Phoenix and Tucson. The water to be recharged will come from surplus flows of CAP water. We believe that proximity to the CAP is a competitive advantage, because it minimizes the cost of water conveyance.

Vidler is able to provide storage for users located both within Arizona and out-of-state. Potential users include industrial companies, developers, and local governmental political subdivisions in Arizona, and out-of-state users such as municipalities and water agencies in Nevada and California. The Arizona Water Banking Authority ("AWBA") has the responsibility for intrastate and interstate storage of water for governmental entities.

Vidler has the only permitted, complete private water storage facility in Arizona. Given that Arizona is the only southwestern state with surplus flows of Colorado River water available for storage, we believe that Vidler's is the only private water storage facility where it is practical to "bank," or store, water for users in other states, which is known as "interstate banking." Having a permitted water storage facility also allows Vidler to acquire, and store, surplus water for re-sale in future years.

Vidler has not yet stored water for customers at the recharge facility, and has not as yet generated any revenue from the facility. We believe that the best economic return on the facility will come from storing water in surplus years for sale in dry years. Vidler has been recharging water for its own account since 1998, when the pilot plant was constructed. At the end of 2006, Vidler had "net recharge credits" representing approximately 115,000 acre-feet of water in storage at the facility, and had purchased or ordered a further 30,000 acre-feet for recharge in 2007. Vidler purchased the water from the CAP, and intends to resell this recharged water at an appropriate time.

Table of Contents

Vidler anticipates being able to recharge 35,000 acre-feet of water per year at the facility, and to store in excess of 1 million acre-feet of water in the aquifer. Vidler's estimate of the aquifer's storage volume is primarily based on a hydrological report prepared by an independent engineering firm for the Central Arizona Water Conservation District in 1990, which concluded that there is storage capacity of 3.7 million acre-feet.

Recharge and recovery capacity is critical, because it indicates how quickly water can be put into storage or recovered from storage. In wet years, it is important to have a high recharge capacity, so that as much available water as possible may be stored. In dry years, the crucial factor is the ability to recover water as quickly as possible. There is a long history of farmers recovering significant quantities of water from the Harquahala Valley ground water aquifer for irrigation purposes.

Vidler is in discussions with a number of developers and other entities which could lead to the sale of net recharge credits. We believe that the storage site, the net recharge credits, and Vidler's remaining water rights and land in the Harquahala Valley could be an attractive combination to developers looking to secure water supply to support new development in the Harquahala Valley, which is approximately 75 miles northwest of metropolitan Phoenix, Arizona. The Vidler Arizona Recharge Facility is located in La Paz County, close to the county line with fast-growing Maricopa County. According to U.S. Census Bureau data, the population of Maricopa County increased 18.3% from 2000 to 2005, with the addition of more than 110,000 people per year. Vidler anticipates that as the boundaries of the greater Phoenix metropolitan area push out, this is likely to lead to demand for water to support growth within the Harquahala Valley itself.

2. Semitropic

Vidler originally had an 18.5% right to participate in the Semitropic Water Banking and Exchange Program, which operates a 1,000,000 acre-foot water storage facility at Semitropic, near the California Aqueduct, northwest of Bakersfield, California.

The strategic value of the guaranteed right to recover an amount of water from Semitropic every year -- even in drought years -- became clear to water agencies, developers, and other parties seeking a reliable water supply. For example, developers of large residential projects in Kern County and Los Angeles County must be able to demonstrate that they have sufficient back-up supplies of water in the case of a drought year before they are permitted to begin development. Accordingly, during 2001, Vidler took advantage of current demand for water storage capacity with guaranteed recovery, and began to sell its interest in Semitropic. The strategic value of the guaranteed right to recover water was again highlighted by two court decisions in February 2003 which held that developers could not rely on water from state water projects.

Vidler's remaining interest includes approximately 30,000 acre-feet of storage capacity. We have the guaranteed right to recover a minimum of approximately 2,700 acre-feet every year. In some circumstances, we have the right to recover up to approximately 6,800 acre-feet in any one year. We are considering various alternatives for the remaining interest, including sale to developers or industrial users. Currently Vidler is not storing any water at Semitropic for third parties. Until 2007, Vidler is required to make an annual payment of approximately $400,000 under its agreement with Semitropic Water Storage District. From 2008, the annual payment drops to $22,000.

Other Projects

Vidler continues to investigate and evaluate water and land opportunities in the southwestern United States, which meet our risk/reward and value criteria, in particular, assets which have the potential to add value to our existing assets. Vidler routinely evaluates the purchase of further water-righted properties in Arizona and Nevada and other states in the southwest and western United States. Vidler also continues to be approached by parties who are interested in obtaining a water supply, or discussing joint ventures to commercially develop water assets and/or develop water storage facilities in Arizona, Nevada, and other southwestern states.

Table of Contents

REAL ESTATE OPERATIONS

Our Real Estate Operations are conducted through