



PURE CYCLE

a water and wastewater services company



Fiscal 2014 Annual Report

Letter to Shareholders

Form 10-K

Proxy Statement

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Dear Shareholders:

We are pleased to share the results of our record year of operations for Fiscal 2014. During the past fiscal year we reported record revenues from operations, doubled our production capacities, added water storage to better serve the water needs of our industrial customers, and removed uncertainties from litigation. Additionally, during the past year (and subsequent to FYE) we have significantly enhanced our balance sheet by eliminating nearly \$60 million in contingent liabilities, thereby enhancing our shareholder's equity.

A key milestone for the year was a successful update to our long standing agreement with the State of Colorado on our Lowry Range water assets and service area. We have a 99-year agreement with the State Land Board, which extends until 2081, under which we are the exclusive water and wastewater service provider to 24,000 acres of property located southeast of Denver. The property is ideally positioned with neighboring development along much of the western border and is also actively being explored for oil & gas development. More broadly, oil & gas operators are developing wells into the Niobrara formation across approximately 150,000 acres in Arapahoe and Adams Counties both within and adjacent to our service areas and we are providing water for these efforts. Fiscal '14's expansion of our water system was in direct response to the growing water demands for oil & gas development; with our having provided water for fracking of approximately 40 wells to date.

As discussed above, during our most recent fiscal year we have eliminated uncertainties regarding past litigation with the State Land Board. Although certain claims by High Plains A&M have been favorably resolved during the past year, there is ongoing litigation over their default on mortgages that they were solely responsible for. The Company has purchased all but one of those defaulted notes and is seeking recovery of our costs associated with High Plains' default.

Finally, subsequent to our year end, working with the Rangeview Metropolitan District and twelve other area water providers, the initial phase of the Water Infrastructure Supply Efficiency project known as "WISE" was completed. WISE is the area's largest regional water development project which interconnects the water systems of different service providers, brings new water supplies to the region, and allows for the purchase and transport of water supplies between and among the service providers. WISE is one of the largest cooperative regional projects in the State's history and will provide additional supplies, improved operations flexibility and reliability, additional storage, and a number of other benefits to the participating members.

As we move into Fiscal 2015, Management and our Board are fortified by our strengthened water systems, both internally and regionally. We are excited about our opportunities to monetize additional assets such as our water storage sites, and increased production capabilities. We are encouraged about the prospects for developing our land assets in conjunction with area developers. A more detailed discussion of our record year of operations follows.

Industrial Water Sales

Colorado's Niobrara shale oil development continues to grow with a record number of active rigs in the State developing horizontal wells accessing several productive benches of the Niobrara and Codell formations across northern and central Colorado. With the advent of horizontal drilling and enhanced well stimulation (a.k.a. fracking), this unconventional oil play continues to produce strong and growing results for domestic oil & gas production. Oil and gas operators have leased nearly 150,000 acres in and around our service areas, have drilled approximately 40 wells to date, and have installed several miles





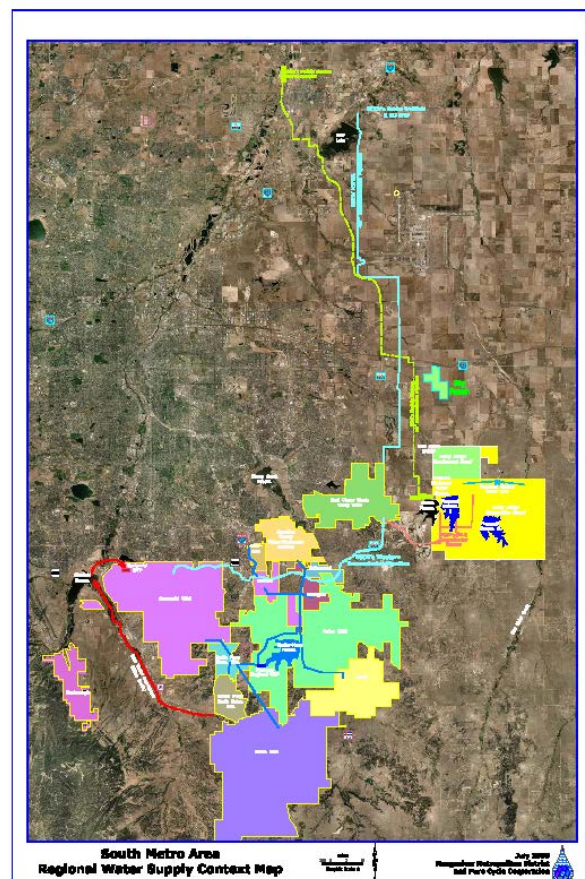
Additionally, we sold approximately 1,900 acres and approximately 3,000 FLCC shares to generate funds to purchase defaulted HP A&M Notes. We now hold approximately 14,900 acres of land and over 18,000 FLCC shares which we lease to area farmers predominately through cash leases which generate over \$1 million in annual revenues from farm operations. Although we continue to explore investing in sprinkler irrigation systems, which we believe will significantly enhance our farm revenues, we have deferred those farm enhancements for the short term in light of the investments in our Denver-based water system.

Domestic Water and Wastewater

We continue to operate our domestic water and wastewater systems to provide high quality wholesale drinking water, irrigation water, and sanitary sewer service to our customers. In addition to operating those facilities we own, we also operate systems owned by others under separate operations agreements. As discussed in previous annual reports, we purchased a 930-acre, fully entitled, master planned community known as Sky Ranch which is zoned for approximately 5,000 single family equivalent units. We believe the Sky Ranch property is competitively positioned and offers very attractive zoning which will allow developers and home builders to offer a wide range of housing products. The Denver real estate market continues to be among the nation's best performing metropolitan housing markets. Since we own the land and are able to provide water and wastewater service on a cost effective and incremental basis, and due to Sky Ranch's proximity to primary transportation corridors (e.g., Interstate 70 and E-470), we believe that Sky Ranch is competitively positioned in the Denver housing market. We look forward to working with area developers and home builders at Sky Ranch.

SMWSA

During 2014, The South Metropolitan WISE Authority ("SMWA") finalized a number of key agreements for its landmark collaborative regional water project known as the Water Infrastructure Supply Efficiency ("WISE") Partnership. WISE allows area water providers to diversify their water supply portfolios, add additional infrastructure to interconnect different water systems, and better work together on additional regional projects to provide new reliable and permanent water supplies. Under the WISE Partnership, Denver and Aurora will provide wholesale treated South Platte River water to participating SMWSA members. Water will be made available through interconnecting transmission systems allowing provider's to move water to and from each other's systems. The Company, together with Rangeview Metropolitan District, holds



certain rights to water storage reservoirs on the Lowry Range. These reservoirs are in close proximity to the regional WISE water systems which, in light of the recently updated State Land Board agreements, may provide enhanced opportunities to integrate the storage into the regional water projects.

LOOKING FORWARD

Our focus for fiscal 2015 will be to continue to meet increased demands of oil and gas customers in and around our service area and along the I-70 corridor; expand our system capabilities through the WISE project's interconnecting infrastructure; and to pursue opportunities to optimize our other assets (e.g., our water storage sites) in conjunction with the WISE project. We will continue to pursue and implement new opportunities to realize increased revenue from our direct management of our farms. We will pursue our remedies under the Asset Purchase Agreement from HP A&M's defaults and hope to conclude our litigation over those defaults. With the continued strength of the Denver housing market and our local economy, we will continue to pursue development partnering opportunities at our Sky Ranch project and work towards defining more certainty regarding development of that project.

Finally, we would like to thank one of our directors Mr. George Middlemas, for over two decades of support and service to the Company and its shareholders. Without Mr. Middlemas' valued contributions, our Company would not be where we are today.

Along with the Company's employees and directors, we remain committed to building shareholder value with our land and water assets and are grateful for your continued support.

Mark W. Harding
President and Chief Executive Officer

Annual Report on Form 10-K
for the
Fiscal Year Ended August 31, 2014



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

Form 10-K

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

For the fiscal year ended August 31, 2014

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

Commission File Number 0-8814

PURE CYCLE CORPORATION

(Exact name of registrant as specified in its charter)

Colorado

(State or other jurisdiction of incorporation or organization)

84-0705083

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

1490 Lafayette St, Suite 203, Denver, CO 80218

(Address of principal executive offices) (Zip Code)

(303) 292-3456

(Registrant's telephone number, including area code)

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

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

(Title of each class)

The NASDAQ Stock Market, LLC

(Name of each exchange on which registered)

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes [] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes [] No [X]

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No []

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No []

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a

smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act:

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

(Do not check if a smaller reporting company)

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant’s most recently completed second fiscal quarter: \$107,694,594

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

DOCUMENTS INCORPORATED BY REFERENCE

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

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

Statements that are not historical facts contained in this Annual Report on Form 10-K, or incorporated by reference into this Form 10-K, are forward-looking statements that involve risk and uncertainties that could cause actual results to differ materially from projected results. The words “anticipate,” “believe,” “estimate,” “expect,” “plan,” “intend” and similar expressions, as they relate to us, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events and are subject to certain risks, uncertainties and assumptions. We cannot assure you that any of our expectations will be realized. Our actual results could differ materially from those discussed in or implied by these forward-looking statements. Forward-looking statements include statements relating to, among other things:

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

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

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

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

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

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

PART I

Item 1 – Business Summary

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

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

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

We plan to utilize our significant water assets along with our adjudicated reservoir sites, which are described in the *Our Water and Land Assets* section below, to provide wholesale water and wastewater services to local

governmental entities. These local governmental entities will in turn provide residential and commercial water and wastewater services to communities along the eastern slope of Colorado in the area extending essentially from Fort Collins on the north to Colorado Springs on the south which is generally referred to as the “Front Range.” Principally we are targeting the “I-70 corridor” which is located east of downtown Denver and south of the Denver International Airport. This area is predominately undeveloped and is expected to experience substantial growth over the next 30 years.

Our farm land consists of approximately 14,900 acres of irrigated land currently being leased to local farmers in southeastern Colorado and we also own 931 acres of land in the I-70 corridor east of Denver, Colorado that is being held for development. These land interests are described in the *Our Water and Land Assets* section below.

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

Glossary of terms

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

- Acre Foot (“aft”) – approximately 326,000 gallons of water, or enough water to cover an acre of ground with one foot of water. For some instances herein, as context dictates, the term acre feet is used to designate an annual decreed amount of water available during a typical year.
- Consumptive Use – the amount of water that is evaporated, transpired, incorporated into products or crops, consumed by humans or livestock, or otherwise removed from the immediate water environment.
- Customer Facilities – facilities that carry potable water and reclaimed water to customers from the retail water distribution system (see “Retail Facilities” below) and collect wastewater from customers and transfer it to the retail wastewater collection system. Water and wastewater service lines, interior plumbing, meters and other components are typical examples of Customer Facilities. In many cases, portions of the Customer Facilities are constructed by the developer, but they are owned and maintained by the customer.
- Non-Tributary Groundwater – underground water in an aquifer which is situated so it neither draws from nor contributes to a natural surface stream in any measurable degree.
- Not Non-Tributary Groundwater – statutorily defined as groundwater located within those portions of the Dawson, Denver, Arapahoe, and Laramie-Fox hills aquifers that are outside of any designated groundwater basin in existence on January 1, 1985.
- Retail Facilities – facilities that distribute water to and collect wastewater from an individual subdivision or community. Developers are typically responsible for the funding and construction of Retail Facilities. Once we certify that the Retail Facilities have been constructed in accordance with our design criteria, the developer dedicates the Retail Facilities to us or to a quasi-municipal political subdivision of the state and we operate and maintain the facilities.
- Section – a parcel of land equal to one square mile and containing 640 acres.
- Single Family Equivalent unit (“SFE”) – One SFE is a customer – whether residential, commercial or industrial – that imparts a demand on our water or wastewater systems similar to the demand of a family of four persons living in a single family house on a standard sized lot. One SFE is assumed to have a water demand of approximately 0.4 acre feet per year and to contribute wastewater flows of approximately 300 gallons per day.
- Special Facilities – facilities that are required to extend services to an individual development and are not otherwise classified as a typical “Wholesale Facility” or “Retail Facility.” Temporary infrastructure required prior to construction of permanent water and wastewater systems or transmission pipelines to transfer water from one location to another are examples of Special Facilities. We typically design and construct the Special Facilities using funds provided by the developer in addition to the normal rates, fees

and charges that we collect from our customers. We are typically responsible for the operation and maintenance of the Special Facilities upon completion.

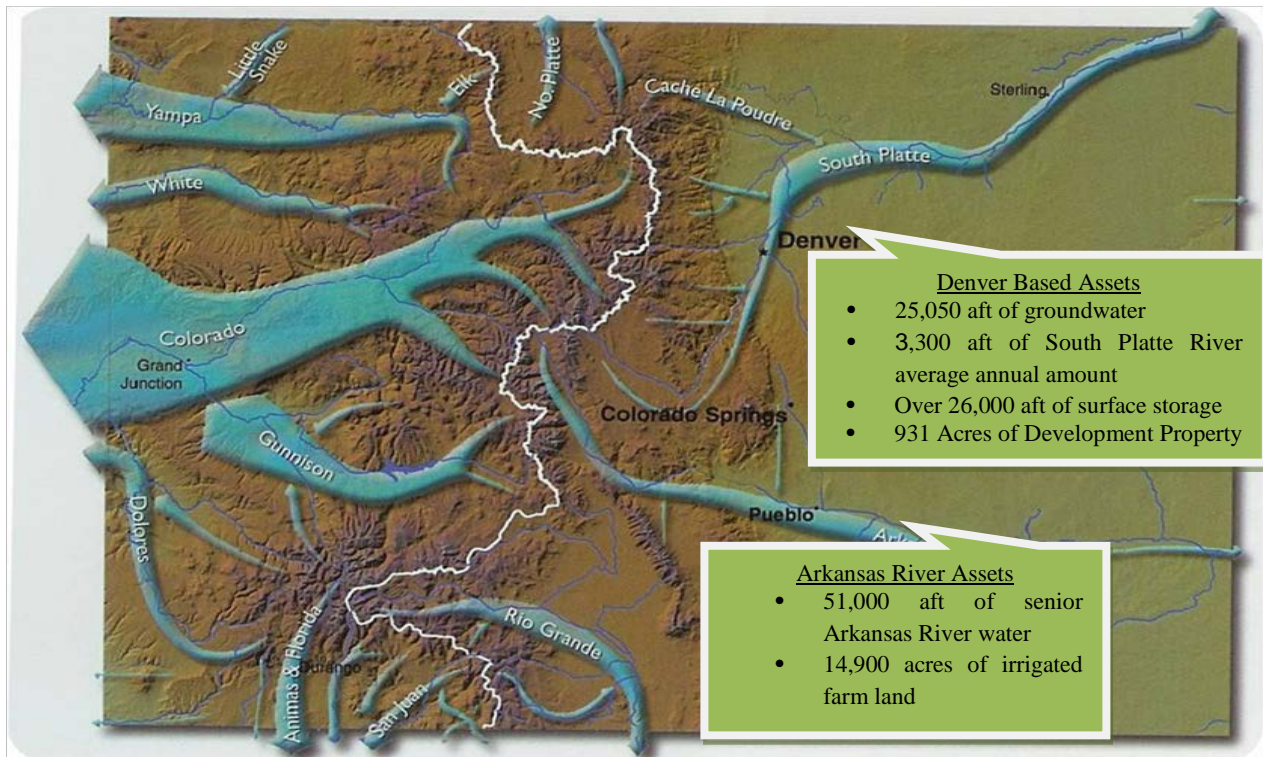
- Tributary Groundwater – all water located in an aquifer that is hydrologically connected to a natural stream and is not considered non-tributary or not non-tributary.
- Tributary Surface Water – water on the surface of the ground flowing in a stream or river system.
- Wholesale Facilities – facilities that serve an entire service area or major regions or portions thereof. Wells, treatment plants, pump stations, tanks, reservoirs, transmission pipelines, and major sewage lift stations are typical examples of Wholesale Facilities. We own, design, construct, operate, maintain and repair Wholesale Facilities which are typically funded using rates, fees and charges that we collect from our customers. .

Our Water and Land Assets

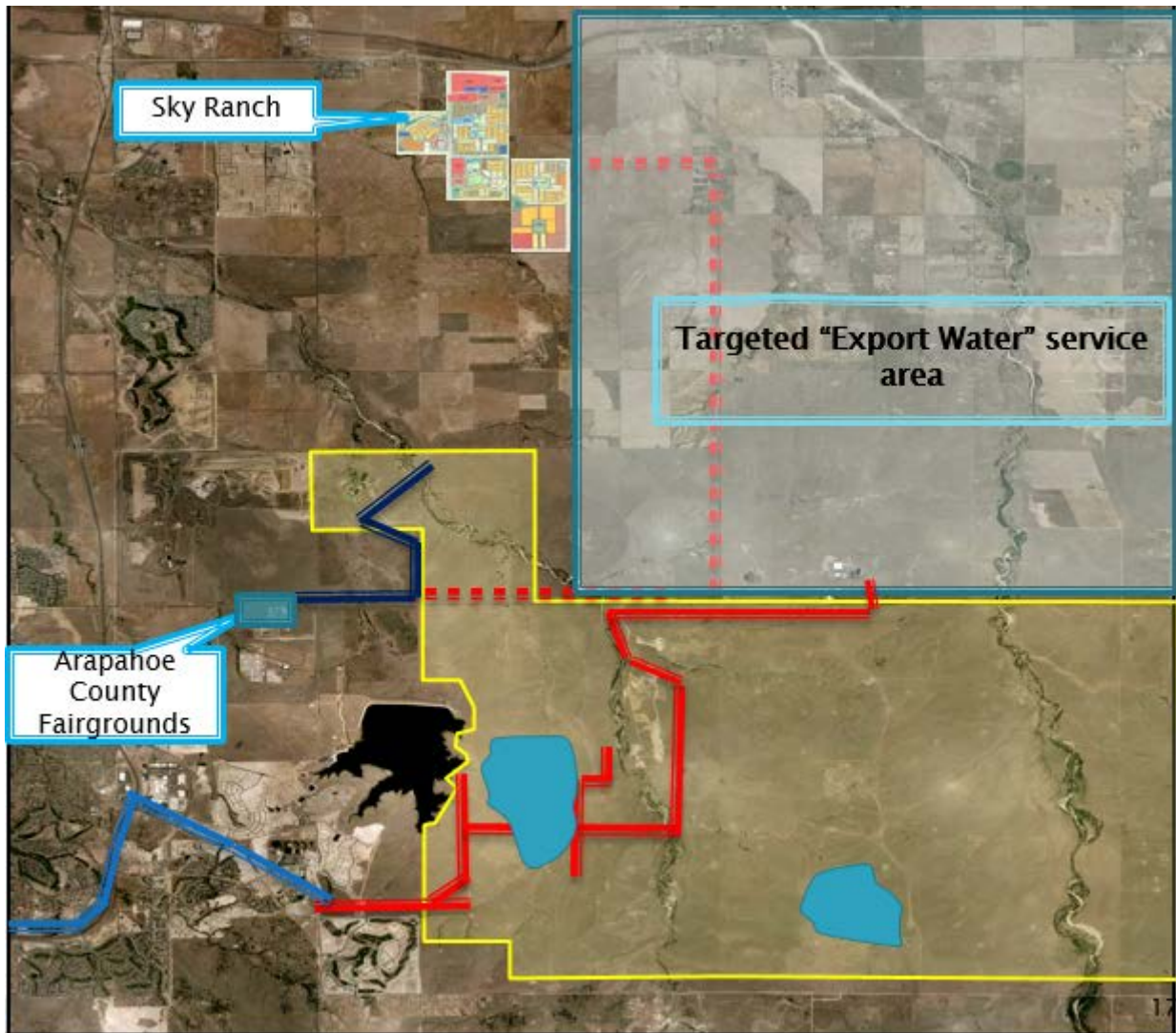
This section should be read in conjunction with *Item 1A – Risk Factors*, *Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Use of Estimates*, and *Note 4 – Water and Land Assets* to the accompanying financial statements.

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

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



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



Rangeview Water Supply and the Lowry Range

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

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

- (i) The 1996 Amended and Restated Lease Agreement between the Land Board and the District which was superseded by the 2014 Amended and Restated Lease Agreement, dated July 10, 2014 (the “Lease”), among the Land Board, the District, and us;
- (ii) The Agreement for Sale of non-tributary and not non-tributary groundwater which we can “export” from the Lowry Range to supply water to nearby communities (this portion of the Rangeview Water Supply is referred to as our “Export Water”) between us and the District (the “Export Agreement”); and

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

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

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

Pursuant to the Rangeview Water Agreements, we design, construct, operate and maintain the District's water and wastewater systems to allow the District to provide water and wastewater service to its customers located within the District's 24,000 acre service area at the Lowry Range. We are the exclusive water and wastewater provider on the Lowry Range, and we operate both the water and the wastewater systems during our contract period on behalf of the District, who owns the facilities for both systems. At the expiration of our contract term in 2081, ownership of the water system facilities servicing customers on the Lowry Range will revert to the Land Board, with the District retaining ownership of the wastewater facilities. Through facilities we own, we use our Export Water, and we intend to use other supplies owned by us, to provide wholesale water service and wastewater service to customers located outside of the Lowry Range, including customers of the District and other governmental entities, industrial, and commercial customers.

Of the 25,050 acre feet of Lowry Range groundwater, we own 11,650 acre feet of Export Water. We also have the right to convert up to 1,650 acre feet of the Export groundwater to a similar amount of surface water for use off the Lowry Range. We hold the exclusive right to develop and deliver through the year 2081 the remaining 13,400 acre feet of groundwater and approximately 3,300 acre feet of average yield surface water to customers either on or off of the Lowry Range. The combined 28,350 acre feet can serve approximately 70,000 SFE's based on the average use of .4 acre feet per SFE.

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

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

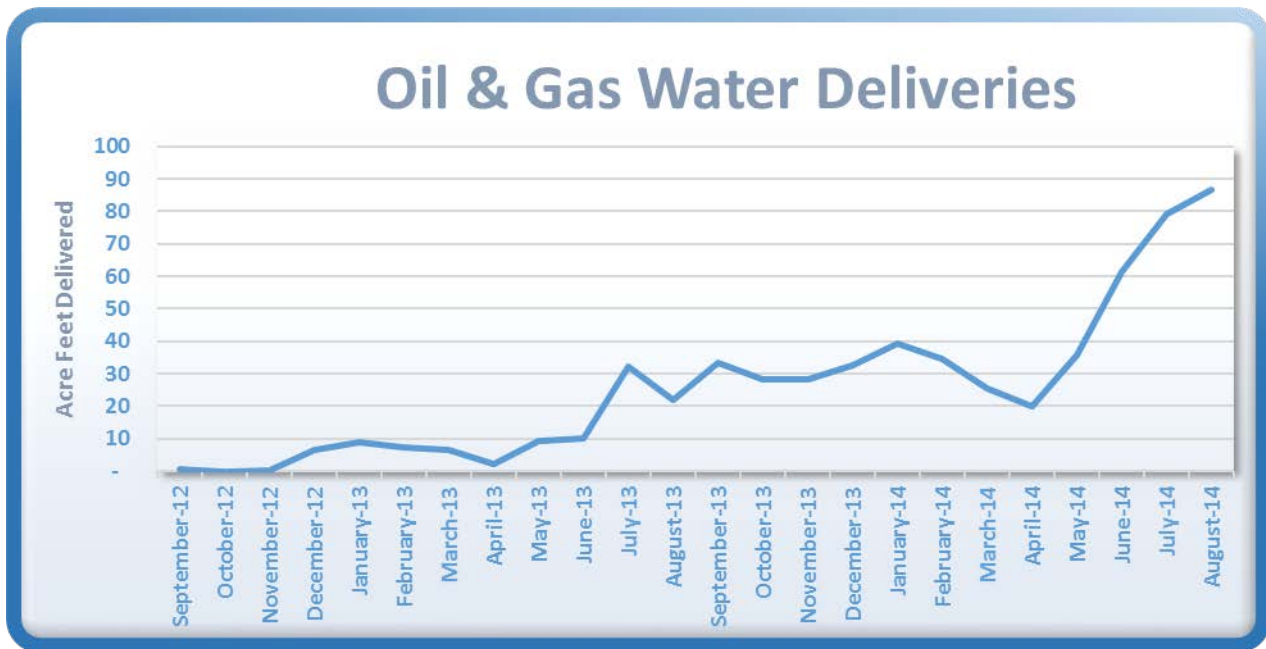
South Metropolitan Water Supply Authority – The South Metropolitan Water Supply Authority ("SMWSA") is a municipal water authority in the State of Colorado organized to pursue the acquisition and development of new water supplies on behalf of its members. SMWSA members include 14 Denver area water providers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

development efforts and in October of 2014 we purchased certain rights to existing pipelines and related infrastructure acquired by the WISE project.

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

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

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



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

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

Sale of Water Rights – In the event we sell our Export Water right outright rather than developing and delivering water service, royalties to the Land Board escalate based on the amount of gross revenue we receive and are lower for sales to a water district or similar municipal or public entity than for sales to a private entity as noted in Table A.

Table A - Royalties for Sale of Water Rights

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

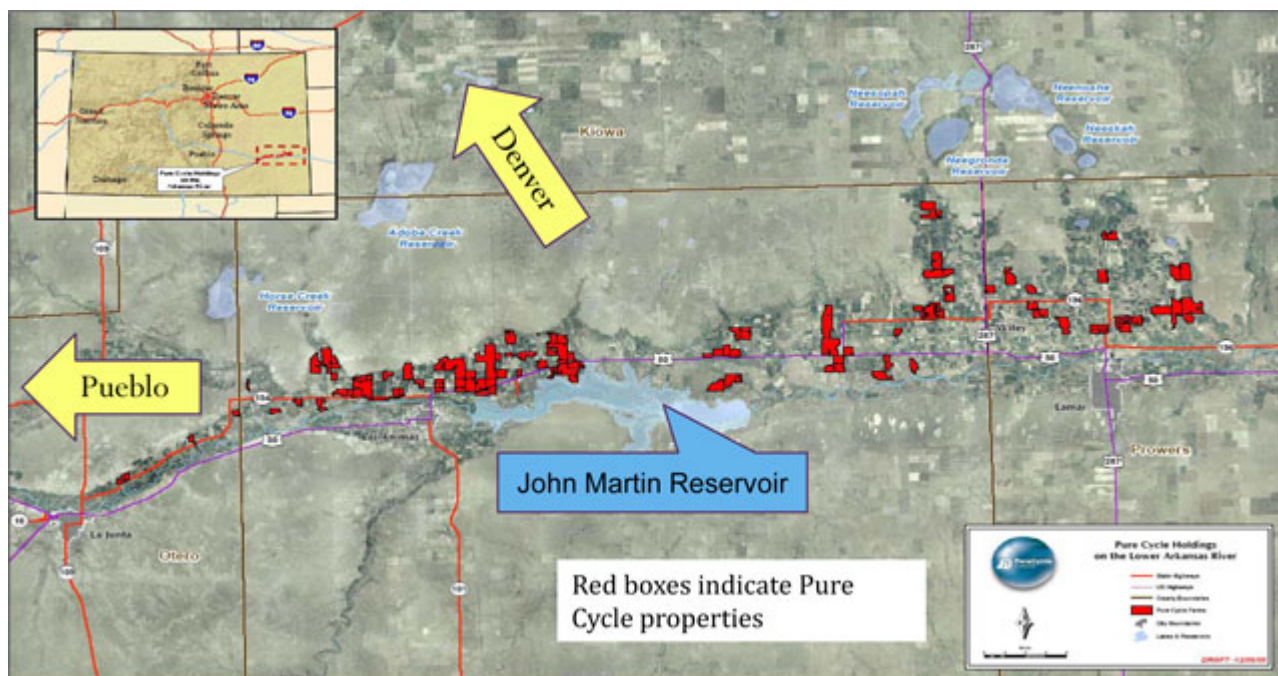
Arkansas River Water and Land

We own approximately 51,000 acre feet of surface water rights in the Arkansas River together with approximately 14,900 acres of farm land in southeastern Colorado, of which approximately 11,800 (79%) is irrigated. The water rights we own are represented by 18,656 shares of the Fort Lyon Canal Company (the “FLCC”), which is a non-profit mutual ditch company established in the late 1800’s to operate and maintain the 110-mile long Fort Lyon Canal between La Junta and Lamar, Colorado. Mineral rights on these farms, if any, are owned approximately 75% by High Plains A&M, LLC (“HP A&M”), and 25% by us. We acquired our Arkansas River water and land from HP A&M pursuant to an Asset Purchase Agreement dated May 10, 2006 (the “Arkansas River Agreement”).

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

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





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

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

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

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

Obligations Payable by HP A&M, Now in Default below for further discussion of the defaults by HP A&M and the remedies under the Arkansas River Agreement, as well as Note 7 – *Long-Term Debt and Operating Lease* and Note 15 – *Subsequent Events* to the accompanying financial statements.

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

Sky Ranch

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

The property includes rights to 820 acre feet of water, approximately 640 acres of oil & gas mineral rights, and has been zoned for residential, commercial and retail uses which may include up to 4,850 SFE's. There is currently no development at Sky Ranch. We currently lease the land to an area farmer and have leased the minerals to ConocoPhillips. We envision that when development at Sky Ranch begins, the development will be in the form of entry level housing (houses costing less than \$300,000); however, we are still evaluating the best use for the property. We plan to partner with home builders/developers to develop the Sky Ranch property. We are anticipating that the home builder/developer will construct infrastructure such as roads, curbs and gutters, and we will construct the necessary water and wastewater systems. Our plan is to provide the market with competitively priced lots that are ready for development together with affordable, sustainable, environmentally sound water and wastewater services.



Although timing for development of this property is unknown, some land development experts believe the entry level housing market is among the most active housing products in the Denver metropolitan area. At full development, the water and wastewater utilities at Sky Ranch are anticipated to generate in excess of \$145 million in tap fee revenue and approximately \$7.5 million annually in wholesale water and wastewater service fee revenue (based on current fees and charges).



Oil and Gas Lease – On March 10, 2011, we entered into a Paid-Up Oil and Gas Lease (the “O&G Lease”) and Surface Use and Damage Agreement (the “Surface Use Agreement”) with Anadarko E&P Company, L.P. (“Anadarko”), a wholly owned subsidiary of Anadarko Petroleum Company. The O&G Lease seeks to capitalize on the growing interest in the region’s Niobrara Oil Formation. Pursuant to the O&G Lease, we received an up-front payment of \$1,900 per net mineral leased acre, or \$1,243,400, and 20% of gross proceeds royalty (less certain taxes) from the sale of any oil and gas produced from our property. In December of 2012 the O&G Lease was purchased by a wholly owned subsidiary of ConocoPhillips. The O&G Lease had a term of three (3) years commencing on March 10, 2011. The lease was extended for an additional two (2) years and we received an additional up-front payment for the extension of \$1,243,400. Pursuant to the Surface Use Agreement,

ConocoPhillips may drill on up to three well pad sites on the Sky Ranch property covered under the O&G Lease. Additionally, we will receive \$3,000 per acre for land that is permanently disturbed for use in the oil and gas exploration and production. During October 2013, ConocoPhillips filed three well permit applications. One permit is for a well to be drilled on the Sky Ranch property. Drilling of this first well was completed in September 2014. The remaining two permits are for wells to be drilled off of Sky Ranch, but will be drilled into the formation under the Sky Ranch property.

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

Arapahoe County Fairgrounds Agreement for Water Service

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

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



Well Enhancement and Recovery Systems

In January 2007, we, along with two other parties, formed Well Enhancement and Recovery Systems, LLC ("Well Enhancement LLC"), to develop a new deep water well enhancement tool and process which we believe will increase the efficiency of wells completed into the Denver Basin groundwater formation. In fiscal 2008, the well enhancement tool and process was completed and tested on two deep water wells developed by an area water provider with favorable results. According to results from studies performed by an independent hydro-geologist, the well enhancement tool effectively increased the production of the two test wells by 80% and 83% when compared to that of nearby wells developed in similar formations at similar depths. Based on the positive results of the test wells, we continue to refine the process of enhancing deep water wells and are marketing the tool to area water providers. On April 27, 2010, we and the other remaining owner of Well Enhancement LLC acquired the third partner's 1/3rd interest in Well Enhancement LLC. Following the acquisition, the remaining partners each hold a 50% interest in Well Enhancement LLC. We used our tool on three wells and one well during our fiscal 2013 and our fiscal 2014, respectively.

Revenues

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

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

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

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

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

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

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

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

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

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

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

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

Farming Operations – We lease our farms to local area farmers on both a cash and a crop share lease basis. Our cash lease farmers are charged a fixed fee, billed semi-annually in March and November. During the November billing cycle our cash lease billings include either a discount or a premium adjustment based on actual water

deliveries by the FLCC. Our crop share lease fees are based on actual crop yields and are received upon the sale of the crops. All fees are estimated and recognized ratably on a monthly basis.

Significant Customers

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

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

Our Projected Operations

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

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

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

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

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

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

In order to use our Arkansas River water for municipal purposes, we must file a change of use application with the Colorado water court. This will likely be a lengthy process and require a substantial amount of capital for legal and engineering services. If we successfully change the use of our water rights to include municipal uses, we would then need to construct a 130-mile pipeline, and water treatment and pumping facilities, from southeastern Colorado to the Denver metropolitan area at an estimated cost of over \$700 million. Since acquiring the Arkansas River supply, we have investigated various pipeline alignments and potential partnerships for construction of these facilities. We do not plan on beginning this process in the near term and anticipate that the tap fees and usage fees we generate from taps sold utilizing our water rights located along the Front Range, along with funding from other pipeline partners, will be sufficient to fund the water delivery facilities when the water is needed along the Front Range. Although we have not yet filed a change of use application, we are working with the FLCC and other interested parties in the Arkansas River Valley to mitigate any adverse impacts to the local communities and to make investments and decisions on farming operations which benefit continued agricultural operations as well as providing new municipal water supplies for the Front Range. We are conducting a rotational crop study program and participating in discussions with area interests including the Lower Arkansas Valley Super Ditch (“Super Ditch”), which is a group of Arkansas Valley irrigators who have assembled to study alternatives to traditional “buy and dry” agricultural-to-municipal water transfers.

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

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

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

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

Water and Growth in Colorado

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

- **Housing Starts** – From September 2012 to September 2013 the annual housing starts increased by 34%. From September 2013 to September 2014 the annual housing starts increased by 14%.
- **Unemployment** – The unemployment rate in Colorado was 5.1% at August 31, 2014 compared to a national unemployment rate of 6.1%. Colorado added an estimated 43,300 jobs from August 2013 to August 2014.
- **Population** – The Denver Regional Council of Governments (“DRCOG”), a voluntary association of over 50 county and municipal governments in the Denver metropolitan area, continues to estimate that the Denver metropolitan area population will increase by about 44% from today’s 2.7 million people to 3.9 million people by the year 2030. A Statewide Water Supply Initiative report by the Colorado Water Conservation Board estimates that the South Platte River basin, which includes the Denver metropolitan region, will grow from a current population of 3.2 million to 4.9 million by the year 2030; while the State’s population will increase from 4.7 million to 7.2 million.
- **Demand** – Approximately 70% of the State’s projected population increase is anticipated to occur within the South Platte River basin. Significant increases in Colorado’s population, particularly in the Denver metro region and other areas in the water short South Platte River basin, together with increasing agricultural, recreational, and environmental water demands will intensify competition for water supplies. The estimated population increases are expected to result in demands for water services in excess of the current capabilities of municipal service providers, especially during drought conditions.
- **Supply** – The Statewide Water Supply Initiative estimates that population growth in the Denver region and the South Platte River basin will result in additional water supply demands of over 400,000 acre feet by the year 2030.
- **Development** – Colorado law requires property developers to demonstrate they have sufficient water supplies for their proposed projects before rezoning or annexation applications will be considered. These factors indicate that water and availability of water will continue to be critical to growth prospects for the region and the state, and that competition for available sources of water will continue to intensify. We focus the marketing of our water supplies and services to developers and homebuilders that are active along the Colorado Front Range as well as other area water providers in need of additional supplies.

Colorado’s future water supply needs will be met through conservation, reuse and the development of new supplies. The District’s rules and regulations for water and wastewater service call for adherence to strict conservation measures, including low flow water fixtures, high efficiency appliances, and advanced irrigation control devices. Additionally, our systems are designed and constructed using a dual-pipe water distribution system to segregate the delivery of high quality potable drinking water to our local governmental entities and their end-use customers through one system and a second system to supply raw or reclaimed water for irrigation demands. About one-half of the water used by a typical Denver-area residential water customer is used for outdoor landscape and lawn irrigation. We believe that raw or reclaimed water supplies provide the lowest cost, most environmentally sustainable water for outdoor irrigation. We expect our systems to include an extensive water reclamation system, in which essentially all effluent water from wastewater treatment plants will be reused to meet non-potable water demands. Our dual-distribution systems demonstrate our commitment to environmentally responsible water management policies in our water short region.

Competition

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

- (i) the purchase of water and wastewater taps in exchange for our obligation to construct certain Wholesale Facilities,
- (ii) the establishment of payment terms, timing, capacity and location of Special Facilities (if any); and
- (iii) specific terms related to our provision of ongoing water and wastewater services to our local governmental customers as well as the governmental entity’s end-use customers.

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

Environmental, Health and Safety Regulation

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

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

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

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

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

In the future, we anticipate changing our method of treating wastewater, which will require future additional capital investments, as additional regulations become effective. We anticipate spending between \$400,000 and \$500,000

during fiscal year 2015 for improvements at our wastewater treatment facilities necessary to maintain compliant operations in light of more stringent discharge criteria for ammonia-nitrogen and chlorine residual.

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

Employees

We currently have seven full-time employees.

Available Information and Website Address

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

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

Item 1A – Risk Factors

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

Our net losses may continue and we may not have sufficient liquidity to pursue our business objectives. We have experienced significant net losses, our cash flows from operations have not been sufficient to fund our operations in the past and we have been required to raise debt and equity capital to remain in operation. Since 2004, we have raised \$30.4 million to support our operations through (i) the issuance of \$25.2 million of common stock (includes the issuance of stock pursuant to the exercise of options, net of expenses) and (ii) the issuance of \$5.2 million of Convertible Debt, which was converted to common stock on January 11, 2011. Our ability to fund our operational needs and meet our business objectives will depend on our ability to generate cash from future operations. We currently have a limited number of customers. If our future cash flows from operations and other capital resources are not sufficient to fund our operations and the significant capital expenditure requirements to build our water delivery systems, we may be forced to reduce or delay our business activities, or seek to obtain additional debt or equity capital. Recent economic conditions and disruptions have caused substantial volatility in capital markets, including credit markets and the banking industry, and have increased the cost and significantly reduced the availability of financing, which may continue or worsen in the future. There can be no assurance that financing will be available on acceptable terms or at all.

The rates the District is allowed to charge customers on the Lowry Range are limited by the Lease with the Land Board and our contract with the District and may not be sufficient to cover our costs of construction and operation. The prices charged by the District for water service on the Lowry Range are subject to pricing regulations set forth in the Lease with the Land Board. Both the tap fees and usage rates and charges are capped at the average of the rates of three nearby water providers. Annually the District surveys the tap fees and rates of the three nearby providers and the District may adjust tap fees and rates and charges for water service on the Lowry Range based on the average of those charged by this group, and we receive 98% of whatever the District charges its customers. Our costs associated with the construction of water delivery systems and the production, treatment and delivery of water

are subject to market conditions and other factors, which may increase at a significantly greater rate than the fees we receive from the District. Factors beyond our control and which cannot be predicted, such as government regulations, insurance and labor markets, drought, water contamination and severe weather conditions, like tornadoes and floods, may result in additional labor and material costs that may not be recoverable under the current rate structure. Either increased customer demand or increased water conservation may also impact the overall cost of our operations. If the costs for construction and operation of our wholesale water services, including the cost of extracting our groundwater, exceed our revenues, we would be providing service to the District for use at the Lowry Range at a loss. The District may petition the Land Board for rate increases; however, there can be no assurance that the Land Board would approve a rate increase request. Further, even if a rate increase were approved, it might not be granted in a timely manner or in an amount sufficient to cover the expenses for which the rate increase was sought.

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

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

We may not be able to obtain sufficient capital to develop our water rights, in particular the Arkansas River water. Development of water rights requires a substantial capital investment. We anticipate financing water and wastewater systems primarily through the sale of water taps and water delivery charges to our customers. However, we cannot assure you that these sources of cash will be sufficient to cover our capital costs. Moreover, the development of the Arkansas River water will require a pipeline or other infrastructure to deliver the water to the Front Range, which is anticipated to cost over \$700 million. We likely would be required to partner with others to finance a project of this magnitude, and there is no assurance we would be able to obtain the financing necessary to develop our Arkansas River water.

We are dependent on the housing market and development in our targeted service areas for future revenues. Providing wholesale water service using our Colorado Front Range water supplies is our principal source of future revenue. The timing and amount of these revenues will depend significantly on housing developments being built near our water assets. The development of these areas is not within our control, and there can be no assurance that development will occur or that water sales will occur on acceptable terms or in the amounts or time required for us to support our costs of operation. In the event wholesale water sales are not forthcoming or development on the Lowry Range, Sky Ranch or other developments in our targeted service area is delayed indefinitely, we would need to incur additional short or long-term debt obligations or seek to sell additional equity to generate operating capital, and there are no assurances that we would be successful in obtaining additional operating capital. After several years of significant declines in new home construction, there have been positive market gains in the Colorado housing market in 2013 and 2014. However, if the downturn in the homebuilding and credit markets return or if the national

economy weakens and economic concerns intensify, it could have a significant negative impact on our business and financial condition.

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

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

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

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

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

We may have contracts in which we guarantee project completion by a scheduled date. At times, we may guarantee that the project, when completed, will achieve certain performance standards. If we fail to complete the project as scheduled, or if we fail to meet guaranteed performance standards, we may be held responsible for cost impacts and/or penalties to the customer resulting from any delay or for the costs to alter the project to achieve the performance standards. To the extent that these events occur and are not due to circumstances for which the

customer accepts responsibility or cannot be mitigated by performance bonds or the provisions of our agreements with contractors, the total costs of the project would exceed our original estimates and our financial results would be negatively impacted.

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

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

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

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

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

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

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

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

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

Contamination to our water supply may result in disruption in our services and litigation, which could adversely affect our business, operating results and financial condition. Our water supplies are subject to contamination, including contamination from naturally occurring compounds, pollution from man-made sources and intentional sabotage. Our land at Sky Ranch and a portion of the Lowry Range have been leased for oil and gas exploration and development. Such exploration and development could expose us to additional contamination risks. In addition, we handle certain hazardous materials at our water treatment facilities, primarily sodium hypochlorite. Any failure of our operation of the facilities or any contamination of our supplies, including sewage spills, noncompliance with water quality standards, hazardous materials leaks and spills, and similar events could expose us to environmental

liabilities, claims and litigation costs. If any of these events occur, we may have to interrupt the use of that water supply until we are able to substitute the supply from another source or treat the contaminated supply. We cannot assure you that we will successfully manage these issues, and failure to do so could have a material adverse effect on our future results of operations.

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

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

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

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

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

that we will have sufficient resources in the future to pay all of the notes. If we were to default on our secured notes in the future, we could lose approximately 6,100 acres of our Arkansas River Properties and 6,700 FLCC shares. The loss of the Arkansas River properties and water rights could have a material adverse effect on our business, operating results and financial condition.

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

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

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

Item 1B – Unresolved Staff Comments

None.

Item 2 – Properties

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

Water Related Assets – In addition to the water rights and adjudicated reservoir sites which are described in *Item 1 – Our Water Assets*, we also own a 500,000 gallon water tank, 400,000 barrel storage reservoir, three deep water wells, a pump station, and several miles of water pipeline in Arapahoe County Colorado. Additionally, although owned by the District, we operate and maintain another 500,000 gallon water tank, two deep water wells, and pump station, three alluvial wells, the District's wastewater treatment plant, and water distribution and wastewater

collection pipelines that serve customers located at the Lowry Range. These assets are used to provide service to our existing customers.

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

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

Item 3 – Legal Proceedings

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

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

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

We filed a lawsuit against HP A&M in the District Court, City and County of Denver, State of Colorado on April 4, 2014, alleging HP A&M breached the Arkansas River Agreement, Seller Pledge Agreement and Property Management Agreement, among other ways, by failing to (i) pay, perform and discharge its obligations when due or otherwise pursuant to the Excluded Indebtedness, (ii) cure defaults under the notes and deeds of trust representing the Excluded Indebtedness, and (iii) use Net Revenue, pursuant to the Property Management Agreement, to pay Excluded Indebtedness. As a result of these breaches, we are claiming damages to be proven at trial, and estimated as of the date of the lawsuit to be not less than \$8 million. HP A&M filed its answer on May 30, 2014, asserting

affirmative defenses and counterclaims, including, among others, breach of contract and breach of implied covenant of good faith and fair dealing and requesting damages in an amount to be proven at trial.

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

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

Item 4 – Mine Safety Disclosures

None.

PART II

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

(a) Market Information

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

Fiscal 2014 quarters ended:	August 31	May 31	February 28	November 30
Market price of common stock				
High	\$ 7.36	\$ 7.00	\$ 7.19	\$ 7.19
Low	\$ 5.40	\$ 4.96	\$ 5.62	\$ 4.34
Fiscal 2013 quarters ended:	August 31	May 31	February 28	November 30
Market price of common stock				
High	\$ 6.72	\$ 7.32	\$ 4.10	\$ 2.78
Low	\$ 5.00	\$ 3.87	\$ 2.31	\$ 1.87

(b) Holders

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

(c) Dividends

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

(d) Securities Authorized For Issuance Under Equity Compensation Plans

Table D - Securities Authorized for Issuance Under Equity Compensation Plans			
Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans:			
Approved by security holders	315,000	\$ 5.76	1,600,000
Not approved by security holders	–	–	–
Total	315,000	\$ 5.76	1,600,000

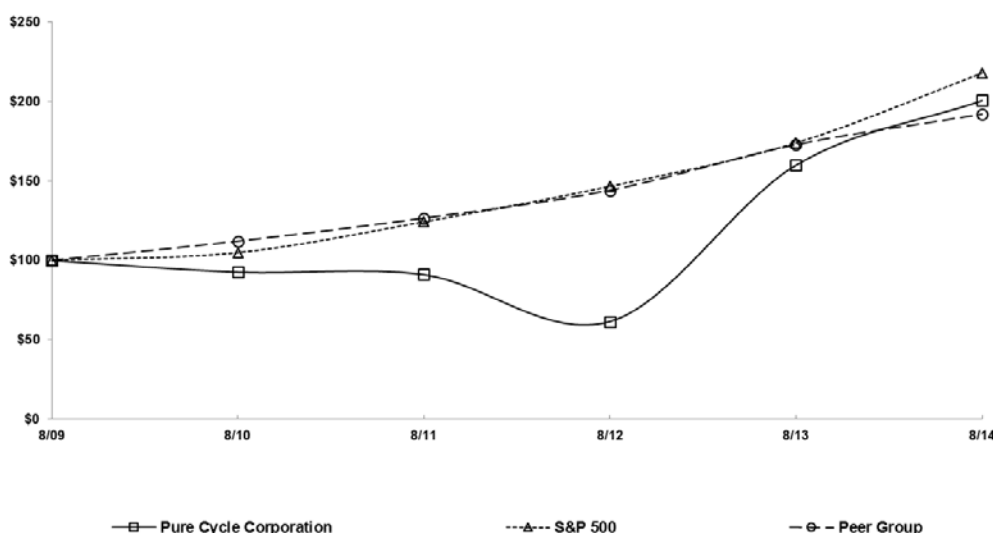
(e) Performance Graph¹

This graph compares the cumulative total return of our common stock for the last five fiscal years with the cumulative total return for the same period of the S&P 500 Index and a peer group index². The graph assumes the

investment of \$100 in common stock in each of the indices as of the market close on August 31 and reinvestment of all dividends.

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

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*
Among Pure Cycle Corporation, the S&P 500 Index,
and a Peer Group



*\$100 invested on 8/31/09 in stock or index, including reinvestment of dividends.
Fiscal year ending August 31.

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1. This performance graph is not “soliciting material,” is not deemed “filed” with the Commission and is not to be incorporated by reference in any of our filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.
2. The Peer Group consists of the following companies that have been selected on the basis of industry focus or industry leadership: American States Water Company, Aqua America, Inc., Artesian Resources Corp., California Water Service Group, Connecticut Water Service, Inc., Middlesex Water Company, Pennichuck Corp., SJW Corp., and The York Water Company.

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

None.

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

None.

Item 6 – Selected Financial Data

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

The following items had a significant impact on our operations:

- In fiscal 2014 in order to protect our farm assets we acquired the remaining approximately \$2.6 million of the \$9.6 million in HP A&M defaulted notes. Additionally, we borrowed \$1.75 million, sold farms for \$5.8 million, and invested \$3.7 million in our water systems. Subsequent to fiscal year end, we refinanced approximately \$1.8 million of the notes we had issued to purchase the notes and deeds of trust defaulted on by HP A&M and we obtained an additional \$1.0 million for working capital. Additionally, we recorded an impairment of approximately \$400,000 on land and water rights held for sale and we recorded a gain of \$1.3 million upon completing the sale of certain farms that we previously impaired in fiscal 2012. See further discussion in Note 4 – *Water and Land Assets* in the accompanying financial statements.
- In fiscal 2013, in order to protect our farm assets, we acquired approximately \$7 million of the \$9.6 million in HP A&M notes. Additionally we sold 1,500,000 unregistered shares of Pure Cycle common stock owned by HP A&M for \$2.35 per share, yielding approximately \$3.4 million, net of expenses.
- In fiscal 2012 the Paradise Water Supply asset was deemed fully impaired and the entire asset value of \$5.5 million was written off and recorded in the accompanying financial statements. Additionally, we recorded an impairment of \$6.5 million on land and water rights held for sale. See further discussion in Note 4 – *Water and Land Assets* in the accompanying financial statements.
- In fiscal 2014, 2013, 2012, 2011 and 2010, respectively, we imputed \$1.4 million, \$3.3 million, \$3.5 million, \$3.8 million, and \$3.6 million of interest related to the Tap Participation Fee payable to HP A&M. As described below, this represents the difference between the net present value and the estimated realizable value of the Tap Participation Fee, which is being charged to expense using the effective interest method over the estimated development period utilized in the valuation of the Tap Participation Fee. The Tap Participation Fee is payable when we sell water taps and receive funds from such water tap sales or other dispositions of property purchased from HP A&M.
- In fiscal 2011, we acquired approximately 931 acres of land known as Sky Ranch for \$7.0 million.

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

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

Overview

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

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

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

Our MD&A section includes the following items:

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

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

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

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

Our Business

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

Wholesale Water and Wastewater

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

We are a vertically integrated wholesale water and wastewater provider, which means we own or control substantially all assets necessary to provide wholesale water and wastewater services to our customers. This includes owning (i) water rights which we use to provide domestic, irrigation, and industrial water to our wholesale customers (we own surface water, groundwater, reclaimed water rights and storage rights), (ii) infrastructure (such

as wells, diversion structures, pipelines, reservoirs and treatment facilities) required to withdraw, treat, store and deliver water, (iii) infrastructure required to collect, treat, store and reuse wastewater, and (iv) infrastructure required to treat and deliver reclaimed water for irrigation use.

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

We plan to utilize our significant water assets along with our adjudicated reservoir sites to provide wholesale water and wastewater services to local governmental entities which in turn will provide residential/commercial water and wastewater services to communities along the eastern slope of Colorado in the area generally referred to as the Front Range. Principally we target the I-70 corridor, which is located east of downtown Denver and south of the Denver International Airport. This area is predominately undeveloped and is expected to experience substantial growth over the next 30 years. We also plan to continue to provide water service to commercial and industrial customers.

Agricultural Operations and Leasing

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

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

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

Critical Accounting Policies and Use of Estimates

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

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

Revenue Recognition

Our revenues consist mainly of monthly service fees, tap fees, construction fees, and beginning in fiscal 2013, farm operations. As further described in Note 2 – *Summary of Significant Accounting Policies* to the accompanying financial statements, proceeds from tap sales and construction fees are deferred upon receipt and recognized in

income based on whether we own or do not own the facilities constructed with the proceeds. We recognize tap fees derived from agreements for which we construct infrastructure owned by others as revenue, along with the associated costs of construction, pursuant to the percentage-of-completion method. The percentage-of-completion method requires management to estimate the percent of work that is completed on a particular project, which could change materially throughout the duration of the construction period and result in significant fluctuations in revenue recognized during the reporting periods throughout the construction process. We did not recognize any revenues pursuant to the percentage-of-completion method during the fiscal years ended August 31, 2014, 2013 or 2012.

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

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

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

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

Impairment of Water Assets and Other Long-Lived Assets

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

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

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

Our Front Range and Arkansas River Water Rights – We determine the undiscounted cash flows for our Denver based assets and the Arkansas River assets by estimating tap sales to potential new developments in our service area and along the Front Range, using estimated future tap fees less estimated costs to provide water services, over an estimated development period. Actual new home development in our service area and the Front Range, actual future tap fees, and actual future operating costs, inevitably will vary significantly from our estimates, which could have a material impact on our financial statements as well as our results of operations. We performed an impairment

analysis as of August 31, 2014, and determined there were no material changes and that our Denver based assets and our Arkansas River assets are not impaired and their costs are deemed recoverable. Our impairment analysis is based on development occurring within areas in which we have service agreements (e.g. Sky Ranch and the Lowry Range) as well as in surrounding areas, including the Front Range and the I-70 corridor. Our combined Rangeview Water Supply, Sky Ranch water and Arkansas River water assets which have a carrying value of \$90.8 million as of August 31, 2014. Based on the carrying value of our water rights, the long term and uncertain nature of any development plans, current tap fees of \$24,620 and estimated gross margins, we estimate that we would need to add 7,600 new water connections (requiring 5.7% of our portfolio) to generate net revenues sufficient to recover the costs of our Rangeview Water Supply and Arkansas River water assets. If tap fees increase 5%, we would need to add 7,200 new water taps (requiring 5.4% of our portfolio) to recover the costs of our Rangeview Water Supply and Arkansas River water assets. If tap fees decrease 5%, we would need to add 8,000 new water taps (requiring 5.9% of our portfolio) to recover the costs of our Rangeview Water Supply and Arkansas River water assets.

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

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

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

Tap Participation Fee

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

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

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

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

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

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

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

- Our obligation to pay HP A&M 20% of the gross proceeds, or the equivalent thereof, from the sale of the next 19,468 water taps as of September 1, 2011, became an obligation to pay 20% of the gross proceeds, or the equivalent thereof, from the sale of the next 2,184 water taps.
- The total undiscounted estimated payments to HP A&M for the TPF decreased \$53.3 million from the previous valuation completed in fiscal 2013. The total estimated payments were then discounted to the current valuation date and the difference between the amount reflected on the Company's balance sheet and the total estimated payments is imputed as interest expense over the estimated development life using the effective interest method. The imputed effective interest rate remained 6.6% and the amount of interest imputed was \$1.4 million for fiscal 2014.

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

Fair Value Estimates

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

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

accrued interest secured by approximately 14,000 acres of farm land and 16,882 FLCC shares representing water rights owned by us.

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

- (i) On August 3, 2012, we formally terminated the Property Management Agreement. See further discussion in *Farm Accounts Receivable and Future Farm Income* below.
- (ii) During September 2012 we sold the Pledged Shares in accordance with the Seller Pledge Agreement yielding approximately \$3.4 million to us.
- (iii) As described in Note 7 – *Long Term Debt and Operating Lease*, to the accompanying consolidated financial statements, to protect our land and water interests, upon a default by HP A&M, at our sole discretion, we may take any measure we deem appropriate to remedy all of the defaults. If we did not protect our interest relating to the defaults, we could have lost the properties and water rights securing the defaulted notes. As of August 31, 2014, we have acquired approximately \$9.4 million of the \$9.6 million of promissory notes that are payable by HP A&M to third parties. These promissory notes were acquired with cash payments of approximately \$2.4 million and the issuance of notes by us. The majority of the notes we issued have a five-year term, bear interest at an annual rate of five percent and require semi-annual payments with a straight-line amortization schedule. The carrying value of the notes payable approximate the fair value as the rates are comparable to market rates.

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

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

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

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

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

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

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

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

Share-based compensation

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

Results of operations

Executive Summary

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

Table G - Summary Results of Operations

	Fiscal Years Ended August 31,			Change			
				2014-2013		2013-2012	
	2014	2013	2012	\$	%	\$	%
Millions of gallons of water delivered	190.1	69.2	34.2	120.9	175%	35.0	102%
Water revenues generated	\$ 1,879,500	\$ 502,700	\$ 182,800	\$ 1,376,800	274%	\$ 319,900	175%
Water delivery operating costs incurred (excluding depreciation and depletion)	\$ 547,600	\$ 188,300	\$ 78,100	\$ 359,300	191%	\$ 110,200	141%
Water delivery gross margin %	71%	63%	57%				
Wastewater treatment revenues	\$ 45,400	\$ 41,700	\$ 45,800	\$ 3,700	9%	\$ (4,100)	-9%
Wastewater treatment operating costs incurred	\$ 38,400	\$ 17,000	\$ 19,300	\$ 21,400	126%	\$ (2,300)	-12%
Wastewater treatment gross margin %	15%	59%	58%				
Farm operations	\$ 1,068,000	\$ 1,241,900	\$ -	\$ (173,900)	-14%	\$ 1,241,900	0%
Farm operations operating costs incurred	\$ 88,100	\$ 96,300	\$ -	\$ (8,200)	-9%	\$ 96,300	0%
Farm operations gross margin %	92%	92%					
General and administrative expenses	\$ 3,356,900	\$ 2,333,100	\$ 2,374,100	\$ 1,023,800	44%	\$ (41,000)	-2%
Net losses	\$ 311,400	\$ 4,150,400	\$ 17,418,700	\$ (3,839,000)	-92%	\$ (13,268,300)	-76%

Changes in Revenues

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

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

Water Revenue Summary

Customer Type	2014			2013			2012		
	Sales (in thousands)	Average kgal	per kgal	Sales (in thousands)	Average kgal	per kgal	Sales (in thousands)	Average kgal	per kgal
On Site	\$ 130.7	23,318.2	\$ 5.61	\$ 138.3	33,831.2	\$ 4.09	\$ 142.3	30,759.9	\$ 4.63
Export-Commercial	31.6	2,318.4	13.63	42.0	4,156.8	10.10	23.7	2,587.6	9.16
Industrial/Fracking	1,717.2	164,502.7	10.44	322.4	34,025.1	9.48	10.2	852.8	11.96
Consulting				-			6.6		
	\$ 1,879.5	190,139.3	\$ 9.88	\$ 502.7	72,013.1	\$ 6.98	\$ 182.8	34,200.3	\$ 5.34

Our gross margin on delivering water (not including depletion charges) was 71%, 63%, and 57% during fiscal 2014, 2013, and 2012, respectively. The increases in our gross margins were due to increased sales and our ability to offset the ECCV system costs with increased water deliveries.

Our wastewater fees increased 9% in fiscal 2014 compared to fiscal 2013 and decreased 9% in fiscal 2013 compared to fiscal 2012. Wastewater fee fluctuations result from demand changes from our only customer.

Farm operations revenues – We began our farm operations during fiscal 2013. Prior to fiscal 2013 we did not generate any revenues from our farming operations pursuant to our agreement with HP A&M. Farm revenues decreased 14% in fiscal 2014 compared to fiscal 2013. The decrease resulted from the disposition of some of our farms during 2014 and also resulted from additional revenue recognized during fiscal 2013 as a result of the timing when we took over management of the farms. The decrease was partially offset in fiscal 2014 because we did not discount lease income for adjusted water deliveries as opposed to fiscal 2013 when we did discount lease billings

due to a drought. The following chart provides a comparison of fiscal 2014 and fiscal 2013 results of sales by the type of lease.

Farm Summary							
Lease Type	2014			2013			
	Sales (in thousands)	Acres (1)	Average per Acre	Sales (in thousands)	Acres	Average per Acre	
Arkansas Cash	\$ 820.3	9,888	\$ 82.96	\$ 1,062.1	10,732	\$ 98.97	
Arkansas Pasture	8.5	1,131	7.52	5.5	1,084	5.07	
Arkansas Water Shares	104.4	N/A	N/A	56.0	N/A	N/A	
Arkansas Crop Share	134.8	1,896	71.10	102.4	1,202	85.19	
Arkansas Held for Sale	-	299	-	-	1,331	-	
Arkansas Not Farmed	-	1,690	-	-	2,361	-	
Sky Ranch	-	931	-	15.9	931	17.08	
	<u>\$ 1,068.0</u>	<u>15,835</u>	<u>\$ 67.45</u>	<u>\$ 1,241.9</u>	<u>17,641</u>	<u>\$ 70.40</u>	

- 1) The amounts included under acres represent the total acres farmed during the fiscal year. Throughout the year, we sold various farms, and at year end, we farmed only 14,900 acres.

General and Administrative Expenses

Table H details significant items, and changes, included in our General and Administrative Expenses (“G&A Expenses”) as well as the impact that share-based compensation has on our G&A Expenses for the fiscal years ended August 31, 2014, 2013 and 2012, respectively.

Table H- G&A Expenses							
Significant G&A Expense items:	Fiscal Years Ended August 31,			Change			
	2014	2013	2012	2014-2013		2013-2012	
				\$	%	\$	%
Salary and salary related expenses	\$ 914,400	\$ 723,500	\$ 699,800	\$ 190,900	26%	\$ 23,700	3%
FLCC water assessment fees	304,300	321,200	361,600	(16,900)	-5%	(40,400)	-11%
Professional fees	1,540,300	370,600	655,800	1,169,700	316%	(285,200)	-43%
Fees paid to directors including insurance	120,400	120,600	124,700	(200)	0%	(4,100)	-3%
Insurance	78,700	56,000	60,600	22,700	41%	(4,600)	-8%
Public entity related expenses	92,500	90,500	98,100	2,000	2%	(7,600)	-8%
Consulting fees	13,100	47,400	2,600	(34,300)	-72%	44,800	1723%
Property taxes	88,700	323,200	112,200	(234,500)	-73%	211,000	188%
All other components of G&A combined	204,500	280,100	258,700	(75,600)	-27%	21,400	8%
G&A Expenses as reported	\$ 3,356,900	\$ 2,333,100	\$ 2,374,100	\$ 1,023,800	44%	\$ (41,000)	-2%
Share-based compensation	(251,900)	(66,800)	(54,600)	(185,100)	277%	(12,200)	22%
G&A Expenses less share-based compensation	<u>\$ 3,105,000</u>	<u>\$ 2,266,300</u>	<u>\$ 2,319,500</u>	<u>\$ 838,700</u>	<u>37%</u>	<u>\$ (53,200)</u>	<u>-2%</u>

Note - salary and salary related expenses excluding share-based compensation:

Salary and salary related expenses	\$ 662,500	\$ 656,700	\$ 645,200	\$ 5,800	1%	\$ 11,500	2%
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Salary and related expenses – Salary and related expenses increased by 26% during fiscal 2014 as compared to fiscal 2013 and increased by 3% during fiscal 2013 as compared to fiscal 2012. The increase in fiscal 2014 compared to fiscal 2013 resulted from the addition of an expense related to options issued to management in fiscal 2013 and the addition of a full time system operator and field service employee. The increase in fiscal 2013 as compared to fiscal 2012 was primarily the result of bonuses paid to management in fiscal 2013 following the successful conversion of our farming operations to our control as well as the addition of capacity to our system. As noted on the bottom line of Table H, salary and related expenses excluding share-based compensation expenses increased 1% during fiscal 2014 compared to fiscal 2013 and increased 2% during fiscal 2014 compared to fiscal 2012. Share-based compensation expenses increased 277% during fiscal 2014 compared to fiscal 2013 due to the issuance of annual options to our independent directors at a higher exercise price than the prior year. Share-based

compensation expenses increased 22% during fiscal 2013 compared to fiscal 2012 due to the issuance of additional options to our independent directors and to our management.

FLCC water assessment fees – We pay fees for our share of the maintenance of the Fort Lyon Canal in Southeast Colorado. The fees are approved by the shareholders of the FLCC. As of August 31, 2014, we hold approximately 19.8% of the voting shares of the FLCC, which was a decrease of 3.4% from August 31, 2013 when we held approximately 23% of the voting shares of the FLCC. FLCC fees decreased 5% during fiscal 2014 compared to fiscal 2013 as a result of the sale of a portion of our farm portfolio, which was partially offset by an increase in the assessment. FLCC fees decreased 11% during fiscal 2013 compared to fiscal 2012 as a result of a decrease in the assessment. FLCC assessments per share were \$16, \$15, and \$17, for the calendar years ended 2014, 2013, and 2012, respectively.

Professional fees (mainly legal and accounting fees) – Professional fees increased 316% during fiscal 2014 compared to fiscal 2013 and decreased 43% during fiscal 2013 compared to fiscal 2012. The increase during fiscal 2014 compared to fiscal 2013 was due to legal fees associated with the Land Board litigation, which increased by \$748,000 and legal fees associated with the HP A&M litigation, which increased by \$463,200. These increases were partially offset by a reduction in general legal fees of \$31,000 and a reduction in accounting fees of \$10,500. The decrease during fiscal 2013 to fiscal 2012 was due to a reduction in legal fees associated with the Land Board litigation of approximately \$188,900, a reduction of legal fees associated with the HP default of \$73,600, and a reduction of general legal fees of \$27,700. The decrease was partially offset by an increase in accounting fees of \$4,900.

Fees paid to our board of directors – Fees for our board in fiscal 2014 include \$49,500 for premiums related to our directors and officers insurance policy (this amount increased by \$3,700 from fiscal 2013). The remaining fiscal 2014 fees of \$70,900 represent amounts paid to our board members for annual and meeting attendance fees and travel expenses, which were somewhat higher than fiscal 2013 due to an increase in the number of board meetings, but due to timing of accruals and payments are \$2,900 less in our 2014 financial statements. Fees paid to our board of directors in fiscal 2013 include \$45,800 for premiums related to our directors and officers insurance policy (this amount increased by \$800 from fiscal 2012). The remaining fiscal 2013 fees of \$74,800 represent amounts paid to our board members for annual and meeting attendance fees and travel expenses which decreased \$4,900 from fiscal 2012, primarily as a result of a reduction in the number of committee meetings.

Insurance – We maintain policies for general liability insurance, workers compensation insurance, and casualty insurance to protect our assets. Insurance expense fluctuates based on the number of employees and premiums associated with insuring our water systems.

Public entity expenses – Costs associated with being a corporation and costs associated with being a publicly traded entity consist primarily of XBRL and Edgar conversion fees, stock exchange fees, and press releases. These costs fluctuate from year-to-year.

Consulting Fees – Consulting fees for fiscal 2013 consisted of \$27,500 to recruit new staff members, \$2,700 for fees associated with the disposal of our Paradise Asset, \$2,000 related to our involvement in WISE, and \$15,200 related to the development of the Sky Ranch water districts. All of these fees are non-recurring. Consulting fees for fiscal 2014 were for similar services but decreased since we did not have a need to pay a recruitment fee during fiscal 2014.

Property Taxes – Our property tax expense decreased from fiscal 2013 to fiscal 2014 by \$234,500 primarily as a result of the reclassification of our Sky Ranch property from commercial to farm land. As of August 31, 2013 we had an accrual of \$57,600 in property taxes related to our Sky Ranch property. The actual property taxes were assessed at \$3,200 resulting in a reduction in our property tax expense of \$54,400 during fiscal 2014. We incurred \$237,400 in property taxes during fiscal 2013 as a result of taking over the management of our farms in August 2012 requiring us to accrue both 2012 taxes due in 2013 and 2013 taxes due in 2014 in one fiscal year. This obligation was previously the responsibility of HP A&M and as such we did not have this expense in previous years.

Other G&A Expenses – Other G&A Expenses include typical operating expenses related to the maintenance of our office, business development, bad debt charges, travel, and district funding. Other G&A decreased 27% during fiscal

2014 compared to fiscal 2013 and increased 8% during fiscal 2013 compared to fiscal 2012. The changes were primarily the result of the timing of various expenses. During fiscal 2013 we incurred additional funding of District expenses of approximately \$24,000, expenses to dispose of our Paradise water asset of \$20,100, and bad debt expense of \$21,200. During fiscal 2012 we incurred farm related expenses resulting from the HP A&M management termination of \$20,600, Sky Ranch expenses of \$23,700, and bad debt expense of \$24,900.

Other Income and Expense Items

	For the Fiscal Years Ended August 31,			Change			
				2014-2013		2013-2012	
	2014	2013	2012	\$	%	\$	%
Other expense items:							
Depreciation and depletion expense	\$ 196,600	\$ 311,200	\$ 309,200	\$ (114,600)	-37%	\$ 2,000	1%
Imputed interest expense	\$ 1,445,500	\$ 3,275,400	\$ 3,470,500	\$ (1,829,900)	-56%	\$ (195,100)	-6%
Interest expense	\$ 239,200	\$ 245,500	\$ -	\$ (6,300)	-3%	\$ 245,500	100%
Other income items:							
Oil and gas lease income	\$ 525,400	\$ 416,000	\$ 423,000	\$ 109,400	26%	\$ (7,000)	-2%
Interest income	\$ 26,900	\$ 34,600	\$ 53,400	\$ (7,700)	-22%	\$ (18,800)	-35%
Other	\$ 160,000	\$ 9,600	\$ 3,600	\$ 150,400	1567%	\$ 6,000	167%
Gain on extinguishment of contingent obligations	\$ 832,100	\$ -	\$ -	\$ 832,100	100%	\$ -	0%
Gain on sale of land and water assets	\$ 1,407,300	\$ -	\$ -	\$ 1,407,300	100%	\$ -	0%

Depreciation and depletion decreased 37% during fiscal 2014 compared to fiscal 2013 due to a number of our assets reaching their full depreciable value and increased 1% during fiscal 2013 compared to fiscal 2012 due to the addition of equipment which we began to depreciate in fiscal 2013.

Imputed interest expense represents the expensed portion of the difference between the relative fair value of the Tap Participation Fee liability payable to HP A&M and the net present value of the liability recognized under the effective interest method. The changes in the imputed interest expense in each of the years presented are a result of the updated valuations performed in first quarter of fiscal 2012, and at the end of fiscal 2013 and 2014, which are explained in greater detail in Note 7- *Long-Term Debt and Operating Lease* to the accompanying financial statements. These imputed interest charges account for 119%, 79% and 20% of our total reported net losses for the fiscal years ended August 31, 2014, 2013 and 2012, respectively.

Interest expense represents the amounts recognized on our farm debt. We acquired the farm notes from third party farms in order to protect out farm assets as the result of the default by HP A&M. The notes were acquired during the fiscal years ended August 31, 2014 and 2013. As such, we did not begin incurring interest expense until fiscal 2013. The mortgage notes generally carry a stated interest rate of 5% and are payable twice per year with a term of five years.

The \$525,400, \$416,000, and \$423,000 of oil and gas lease payments recognized in fiscal 2014, fiscal 2013, and fiscal 2012 respectively, primarily represent the up-front payment received on March 10, 2011, upon the signing of the O&G Lease and Surface Use Agreement. On March 10, 2011 we received an up-front payment of \$1,243,400 for the purpose of exploring for, developing, producing and marketing oil and gas on 634 acres of mineral estate we own at our Sky Ranch property. The oil and gas rights under the remaining 304 acres at Sky Ranch were already owned by a third party. We deferred immediate recognition of the up-front payment, but began recognizing the up-front payment in income over the initial three year term of the O&G Lease beginning March 10, 2011. During February 2014 we received an additional payment of \$1,243,400 to extend the initial term of the O&G Lease by an additional two years through February 2016. The income received for the extension is being recognized in income over the two year extension term of the O&G Lease. As of August 31, 2014, we have deferred recognition of \$1,025,500 of income related to the O&G Lease.

Interest income represents interest earned on the temporary investment of capital in cash equivalents or available-for-sale securities, finance charges, interest accrued on the note receivable from the District and interest accrued on

the Special Facilities construction proceeds receivable from the County. The decrease from fiscal 2013 compared to fiscal 2014 is due to reduced investments and the elimination of construction interest as a result of the County paying off the balance of the note in March 2013. The decrease from fiscal 2012 compared to fiscal 2013 is due to reduced investments partially offset by increased farm late fees.

Other income represents payments we received for various easements and the construction of infrastructure for the oil and gas industry. During fiscal 2014 we received a number of payments for easements for the development of oil and gas on our Rangeview and Sky Ranch properties.

Gain on extinguishment of contingent obligations resulted from the relinquishment of the CAA interest held by the Land Board. As part of the settlement of the Land Board litigation the Land Board assigned its interest in the CAA to us.

During fiscal 2014 we completed the sale of certain farms as further described in Note 4 – *Water and Land Assets*. We also recognized a gain related to easements on our properties totaling approximately \$100,000.

Liquidity, capital resources and financial position

At August 31, 2014, our working capital, defined as current assets less current liabilities, was \$1.2 million, which includes \$1.75 million in cash and cash equivalents. Subsequent to fiscal year end, we borrowed \$4,450,000 from the First National Bank of Las Animas to refinance a number of the notes we had issued to purchase the defaulted notes payable by HP A&M and to add \$1 million to our working capital. The note has a 20 year term commencing October 27, 2014, requires semi-annual payments and carries a 5.27% per annum rate for the first five years. The note is secured by a total of 3,596.8 acres, 3,282 FLCC shares, and an assignment of two HP A&M notes and deeds of trust with balances due of approximately \$843,400, which are secured by 1,087.4 FLCC shares. After the first five years the interest rate on the note is subject to change (no more often than annually) based on the changes in the First National Bank of Las Animas Ag/Commercial Real Estate Rate. We may pay the note in full at any time without penalty. We have an effective shelf registration statement pursuant to which we may elect to sell up to another \$15 million of common stock at any time and from time to time. During fiscal 2012 we sold the 1.5 million Pledged Shares for \$3.5 million or \$2.35 per share. We believe that as of the date of the filing of this annual report on Form 10-K and as of August 31, 2014, we have sufficient working capital to fund our operations for the next fiscal year.

Arkansas River Valley Water Assets – The FLCC water assessments are the charges assessed to the FLCC shareholders for the upkeep and maintenance of the Fort Lyon Canal. The water assessment payments are payable to the FLCC each calendar year. For the calendar year 2014, FLCC water assessments increased from \$15 to \$16 per share, which will increase our expenses by approximately \$22,900 to \$312,900, which will be expensed ratably during calendar 2014. Our calendar year 2013 property taxes were approximately \$150,500. Based on these taxes we are accruing monthly property taxes of approximately \$11,700 for calendar year 2014. Our calendar year assessments for 2013 were approximately \$290,000 and were expensed ratably during the year. Our calendar year 2012 property taxes (paid in April 2013) for our Arkansas River farm properties were approximately \$142,000.

ECCV Capacity Operating System – Pursuant to a 1982 contractual right, the District may purchase water produced from the ECCV Land Board system. ECCV's Land Board system is comprised of eight wells and more than ten miles of buried water pipeline located on the Lowry Range. In May 2012, in order to increase the delivery capacity and reliability of these wells, in our capacity as the District's service provider and the Export Water Contractor (as defined in the Lease, we entered into an agreement to operate and maintain the ECCV facilities allowing us to utilize the system to provide water to commercial and industrial customers, including customers providing water for drilling and hydraulic fracturing of oil and gas wells. Our costs associated with the use of the ECCV system were a flat monthly fee of \$4,667 per month from May 1, 2012 through December 31, 2012, which increased to \$8,000 per month from January 1, 2013 through December 31, 2020, and will decrease to \$3,000 per month from January 1, 2020 through April 2032. Additionally, we pay a fee per 1,000 gallons of water produced from ECCV's system, which is included in the water usage fees charged to customers.

The Tap Participation Fee - The \$7.9 million TPF liability at August 31, 2014, represents the estimated fair value of our obligation to pay HP A&M 20% of our gross proceeds, or the equivalent thereof, from the sale of the next

2,184 water taps we sell. To date we have imputed \$27.5 million of interest since 2006 when we acquired our farm assets, recorded using the effective interest method. We did not sell any taps during the fiscal years ended August 31, 2014 or 2013.

Payment of the TPF may be accelerated in the event of a merger, reorganization, sale of substantially all assets, or similar transactions and in the event of bankruptcy and insolvency events. Through August 2014 foreclosure sales were completed on 35 of our farms and three FLCC certificates representing water rights only, and we withdrew one farm from foreclosure. Our agreement with HP A&M allows us to reduce the TPF in the event any of our farms or water rights are foreclosed upon. Foreclosures as of August 31, 2014 have resulted in a reduction of 17,243 taps. As of August 31, 2014, there were 2,184 taps remaining subject to the TPF. As a result of the foreclosures and the reduction in taps remaining subject to the TPF, the TPF was revalued as of August 31, 2014 and 2013. Two additional foreclosure sales were completed after the end of the fiscal year. See Note 15 – *Subsequent Events*.

South Metropolitan Water Supply Authority – The South Metropolitan Water Supply Authority (“SMWSA”) is a municipal water authority in the State of Colorado organized to pursue the acquisition and development of new water supplies on behalf of its members. SMWSA members include 14 Denver area water providers in Arapahoe and Douglas Counties. The District became a member of SMWSA in 2009 in an effort to participate with other area water providers in developing regional water supplies along the Front Range. For over three years, the SMWSA members have been working with Denver Water and Aurora Water on a cooperative water project known as the Water Infrastructure Supply Efficiency partnership (“WISE”), which seeks to develop regional infrastructure which would interconnect members’ water transmission systems to be able to develop additional water supplies from the South Platte River in conjunction with Denver Water and Aurora Water. In July of 2013, the District together with nine other SMWSA members formed the South Metropolitan Wise Authority (“SMWA”) to continue to develop the WISE project. Through our funding agreement with the District and subsequent to fiscal year end, we made payments of \$535,200 to purchase certain rights to use existing water transmission and related infrastructure acquired by the WISE project. We anticipate we will be investing approximately \$1.2 million per year for the next five years for additional payments for the water transmission line and additional facilities, water and related assets for the WISE project.

Summary Cash Flows Table

	For the Fiscal Years Ended August 31,			Change			
	2014	2013	2012	2013-2012		2012-2011	
				\$	%	\$	%
Cash (used) provided by:							
Operating activities	\$ 51,700	\$ (1,756,700)	\$ (1,887,100)	\$ 1,808,400	-103%	\$ 130,400	-7%
Investing activities	\$ 2,136,300	\$ 4,098,100	\$ 3,354,000	\$ (1,961,800)	-48%	\$ 744,100	22%
Financing activities	\$ (2,886,900)	\$ (1,516,500)	\$ 84,900	\$ (1,370,400)	90%	\$ (1,601,400)	-1886%

Changes in Operating Activities – Operating activities include revenues we receive from the sale of wholesale water and wastewater services, costs incurred in the delivery of those services, G&A Expenses, and depletion/depreciation expenses.

Cash used by operations in fiscal 2014 decreased by \$1,808,400 compared to fiscal 2013, which was due primarily to the decrease in net operating losses, which was the result of increased revenues. Cash used by operations in fiscal 2013 decreased by \$130,000 compared to fiscal 2012, which was due mainly to increased revenues and reduced legal fees related to the Land Board litigation. These were partially offset by an increase in accounts receivable and the HP default receivable.

We will continue to provide wholesale domestic water and wastewater services to customers in our service area and we will continue to operate and maintain our water and wastewater systems with our own employees.

Changes in Investing Activities – Investing activities in fiscal 2014 consisted of the sale of some of our farms and easements on our land, which generated \$5.8 million and the addition of approximately \$3.9 million in water assets, which primarily consisted of the addition of three wells to our system. Investing activities in fiscal 2013 consisted of the investment in our water system and purchase of water infrastructure assets of \$418,000, the sale of marketable

securities of \$1.1 million, and the sale of collateral stock of \$3.4 million. Investing activities in fiscal 2012 consisted of the purchase of marketable securities of \$1.2 million and the sale of marketable securities of \$4.7 million.

Changes in Financing Activities – Financing activities in fiscal 2014 consisted primarily of payments on our promissory notes of \$2.9 million. Financing activities in fiscal 2013 consisted primarily of payments on our promissory notes of \$1.8 million and the receipt of \$292,000 from the County pursuant to the County Agreement and the early payoff of the debt. Financing activities in fiscal 2012 consisted of the receipt of \$85,000 from the County pursuant to the County Agreement.

Off-Balance Sheet Arrangements

Our off-balance sheet arrangements consist entirely of the contingent portion of the CAA which is \$662,500, as described in Note 5 – *Participating Interest in Export Water* to the accompanying financial statements. The contingent liability is not reflected on our balance sheet because the obligation to pay the CAA is contingent on sales of Export Water, the amounts and timing of which are not reasonably determinable.

Recently Adopted and Issued Accounting Pronouncements

See Note 2 – *Summary of Significant Accounting Policies* to the accompanying financial statements for recently adopted and issued accounting pronouncements.

Total Contractual Cash Obligations

Table K - Contractual Cash Obligations					
	Total	Payments due by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual obligations	\$ 4,958,200	\$ 926,000	\$ 2,444,700	\$ 804,300	\$ 783,200
Operating lease obligations	6,300	6,300	(b)	(b)	(b)
Participating Interests in Export Water	354,600	(c)	(c)	(c)	(c)
Tap Participation Fee payable to HP A&M	11,182,900	(d)	(d)	(d)	(d)
Total	\$ 16,502,000	\$ 932,300	\$ 2,444,700	\$ 804,300	\$ 783,200

- (a) Our contractual obligations are related to our Arkansas Valley farms. We have refinanced most farms with notes having a five-year term, bearing interest at an annual rate of five percent and requiring semi-annual payments with a straight-line amortization schedule.
- (b) Our only operating lease is related to our office space. We occupy 1,200 square feet at a cost of \$1,580, per month, at the address shown on the cover of this Form 10-K. We lease these premises pursuant to a two year operating lease agreement which expires in December 2014 with a third party.
- (c) The participating interests liability is payable to the CAA holders upon the sale of Export Water, and therefore, the timing of the payments is uncertain and not reflected in the above table by period.
- (d) The Tap Participation Fee payable to HP A&M is payable upon the sale of water taps. Because the timing of these water tap sales is not fixed and determinable, the estimated payments are not reflected in the above table by period. The amount listed above includes an unamortized discount of \$3.9 million. The Tap Participation Fee is described in greater detail in Note 7 – *Long-Term Debt and Operating Lease* to the accompanying financial statements.

Item 7A – Quantitative and Qualitative Disclosures About Market Risk

General

We have limited exposure to market risks from instruments that may impact our balance sheets, statements of operations, and statements of cash flows. Such exposure is due primarily to changing interest rates.

Interest Rates

The primary objective for our investment activities is to preserve principal while maximizing yields without significantly increasing risk. This is accomplished by investing in diversified short-term interest bearing investments. As of August 31, 2014, we are not holding any marketable securities while we expand our water systems. We have no investments denominated in foreign country currencies, and therefore our investments are not subject to foreign currency exchange risk.

Item 8 – Consolidated Financial Statements and Supplementary Data

Index to Consolidated Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Pure Cycle Corporation

We have audited the accompanying balance sheets of Pure Cycle Corporation as of August 31, 2014 and 2013, and the related statements of operations, shareholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended August 31, 2014. We also have audited Pure Cycle Corporation's internal control over financial reporting as of August 31, 2014, based on criteria established in *Internal Control—Integrated Framework 1992* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Pure Cycle Corporation's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Pure Cycle Corporation's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pure Cycle Corporation as of August 31, 2014 and 2013, and the results of its operations and its cash flows for each of the years in the three-year period then ended in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, Pure Cycle Corporation maintained, in all material respects, effective internal control over financial reporting as of August 31, 2014, based on criteria established in *Internal Control—Integrated Framework 1992* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/ GHP HORWATH, P.C

Denver, Colorado
November 14, 2014

PURE CYCLE CORPORATION
CONSOLIDATED BALANCE SHEETS

ASSETS:	August 31, 2014	August 31, 2013
Current assets:		
Cash and cash equivalents	\$ 1,749,558	\$ 2,448,363
Trade accounts receivable, net	1,626,090	584,802
Sky Ranch receivable	50,915	57,303
Current portion of HP A&M receivable	–	6,655,156
Land and water held for sale	699,826	–
Prepaid expenses	336,867	154,345
Total current assets	4,463,256	9,899,969
Investments in water and water systems, net	90,823,916	88,512,249
Land - Sky Ranch	3,662,754	3,768,029
Land and water held for sale	1,500,000	5,748,630
Note receivable - related party:		
Rangeview Metropolitan District, including accrued interest	568,022	555,983
HP A&M receivable, less current portion	7,069,511	–
Other assets	86,363	133,471
Total assets	\$ 108,173,822	\$ 108,618,331
LIABILITIES:		
Current liabilities:		
Accounts payable	1,379,647	167,775
Current portion mortgages payable, including interest payable of \$80,847 and \$122,028, respectively	925,980	4,668,943
Accrued liabilities	257,893	264,740
Deferred revenues	65,124	65,384
Deferred oil and gas lease payment	645,720	235,483
Total current liabilities	3,274,364	5,402,325
Deferred revenues, less current portion	1,167,095	1,232,220
Deferred oil and gas lease payment, less current portion	379,765	–
Mortgages payable, less current portion	4,032,227	3,211,112
Participating interests in Export Water Supply	354,628	1,192,910
Tap Participation Fee payable to HP A&M net of \$4.1 million and \$42.9 million discount respectively	7,935,262	59,807,289
Total liabilities	17,143,341	70,845,856
Commitments and Contingencies		
SHAREHOLDERS' EQUITY:		
Preferred stock:		
Series B - par value \$.001 per share, 25 million shares authorized 432,513 shares issued and outstanding (liquidation preference of \$432,513)	433	433
Common stock:		
Par value 1/3 of \$.01 per share, 40 million shares authorized; 24,037,598 shares issued and outstanding	80,130	80,130
Additional paid in capital	168,794,396	115,224,946
Accumulated comprehensive loss	–	–
Accumulated deficit	(77,844,478)	(77,533,034)
Total shareholders' equity	91,030,481	37,772,475
Total liabilities and shareholders' equity	\$ 108,173,822	\$ 108,618,331

See accompanying Notes to Financial Statements

PURE CYCLE CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Fiscal Years Ended August 31,		
	2014	2013	2012
Revenues:			
Metered water usage	\$ 1,879,495	\$ 502,668	\$ 182,802
Wastewater treatment fees	45,400	41,697	45,778
Special facility funding recognized	41,508	41,508	41,508
Water tap fees recognized	14,294	14,294	14,296
Farm operations	1,068,026	1,241,882	-
Other income	42,417	15,413	-
Total revenues	<u>3,091,140</u>	<u>1,857,462</u>	<u>284,384</u>
Expenses:			
Water service operations	(547,562)	(188,309)	(78,144)
Wastewater service operations	(38,426)	(16,958)	(19,269)
Farm operations	(88,105)	(96,337)	-
Other	(39,421)	(1,199)	(1,995)
Depletion and depreciation	(149,757)	(90,468)	(88,576)
Total cost of revenues	<u>(863,271)</u>	<u>(393,271)</u>	<u>(187,984)</u>
Gross margin	2,227,869	1,464,191	96,400
General and administrative expenses	(3,356,863)	(2,333,126)	(2,374,106)
Impairment of land and water rights held for sale	(402,657)	-	(6,457,760)
Impairment of water assets	-	-	(5,544,022)
Depreciation	(46,807)	(220,834)	(220,657)
Operating loss	<u>(1,578,458)</u>	<u>(1,089,769)</u>	<u>(14,500,145)</u>
Other income (expense):			
Oil and gas lease income, net	525,438	416,048	422,999
Farm income, net	-	-	71,101
Interest income	26,858	34,583	53,339
Interest expense	(239,200)	(245,503)	-
Other	160,004	9,574	3,552
Gain on sale of land and water assets	1,407,326	-	1,016
Gain on extinguishment of contingent obligations	832,097	-	-
Interest imputed on the Tap Participation Fees payable to HP A&M	(1,445,509)	(3,275,378)	(3,470,523)
Net loss	<u>\$ (311,444)</u>	<u>\$ (4,150,445)</u>	<u>\$ (17,418,661)</u>
Net loss per common share – basic and diluted	<u>\$ (0.01)</u>	<u>\$ (0.17)</u>	<u>\$ (0.72)</u>
Weighted average common shares outstanding – basic and diluted			
	<u>24,037,598</u>	<u>24,037,598</u>	<u>24,037,598</u>

See accompanying Notes to Financial Statements

PURE CYCLE CORPORATION
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)

	Preferred Stock		Common Stock		Additional	Accumulated	Accumulated	Total
	Shares	Amount	Shares	Amount	Paid-in	Comprehensive		
					Capital	Income (loss)		
August 31, 2011 balance:	432,513	433	24,037,598	80,130	103,176,607	(2,903)	(55,963,928)	47,290,339
Share-based compensation	-	-			54,588			54,588
Allocation of net revenues to TPF					189,674			189,674
Unrealized loss on investments	-	-				1,822		1,822
Net loss	-	-					(17,418,661)	(17,418,661)
Comprehensive loss								(17,416,839)
August 31, 2012 balance:	432,513	433	24,037,598	80,130	103,420,869	(1,081)	(73,382,589)	30,117,762
Share-based compensation	-	-	-	-	66,812	-	-	66,812
Reduction in TPF due to remedies under the Arkansas River Agreement	-	-	-	-	11,737,265	-	-	11,737,265
Realized gain on investments	-	-	-	-	-	1,081	-	1,081
Net loss	-	-	-	-	-	-	(4,150,445)	(4,150,445)
Comprehensive loss								(4,149,364)
August 31, 2013 balance:	432,513	\$ 433	24,037,598	\$ 80,130	\$ 115,224,946	\$ -	\$ (77,533,034)	\$ 37,772,475
Share-based compensation	-	-	-	-	251,915	-	-	251,915
Reduction in TPF due to remedies under the Arkansas River Agreement	-	-	-	-	53,317,535	-	-	53,317,535
Net loss	-	-	-	-	-	-	(311,444)	(311,444)
Comprehensive loss								(311,444)
August 31, 2014 balance:	432,513	\$ 433	24,037,598	\$ 80,130	\$ 168,794,396	\$ -	\$ (77,844,478)	\$ 91,030,481

See accompanying Notes to Financial Statements

PURE CYCLE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the fiscal Years Ended August 31,		
	2014	2013	2012
Cash flows from operating activities			
Net loss	\$ (311,444)	\$ (4,150,445)	\$ (17,418,661)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Share-based compensation expense	251,915	66,812	54,588
Depreciation, depletion and other non-cash items	196,564	313,137	307,507
Investment in Well Enhancement Recovery Systems, LLC	(37,193)	-	-
Imputed interest on Tap Participation Fees payable to HP A&M	1,445,509	3,275,378	3,470,523
Impairment of water assets	-	-	5,544,022
Impairment of land and water rights held for sale	402,657	-	6,457,760
Gain on the sale of land and water rights held for sale	(1,308,392)	-	-
Interest income and other non-cash items	(420)	-	-
Interest added to note receivable - related party			
Rangeview Metropolitan District	(12,039)	(12,038)	(12,072)
Interest added to construction proceeds receivable	-	-	(19,241)
Gain on sale of fixed assets	-	-	(1,016)
Gain on extinguishment of contingent obligations	(832,097)	-	-
Changes in operating assets and liabilities:			
Trade accounts receivable	(1,041,288)	(449,344)	(36,974)
Prepaid expenses	(168,795)	125,437	(37,782)
HP A&M Receivable	(414,355)	(519,934)	-
Sky Ranch Receivable	6,388	(57,303)	-
Accounts payable and accrued liabilities	1,191,298	120,527	246,034
Interest accrued on agriculture land promissory notes	(41,181)	-	-
Deferred revenue	(65,385)	(65,385)	(27,314)
Deferred income - oil and gas lease	790,002	(403,507)	(414,480)
Net cash provided by (used in) operating activities	<u>51,744</u>	<u>(1,756,665)</u>	<u>(1,887,106)</u>
Cash flows from investing activities:			
Investments in water, water systems and land	(3,864,443)	(378,008)	(132,221)
Purchases of marketable securities	-	-	(1,235,857)
Sales and maturities of marketable securities	-	1,101,367	4,724,847
Proceeds from sale of land and easements	192,851	-	1,099
Proceeds from sale of farm land	5,811,265	-	-
Proceeds from sale of collateral stock	-	3,415,000	-
Purchase of property and equipment	(3,370)	(40,300)	(3,894)
Net cash provided by investing activities	<u>2,136,303</u>	<u>4,098,059</u>	<u>3,353,974</u>
Cash flows from financing activities			
Arapahoe County construction proceeds	-	291,662	84,854
Payment to contingent liability holders	(6,185)	(16,018)	-
Payments made on promissory notes payable	(2,880,667)	(1,792,192)	-
Net cash (used in) provided by financing activities	<u>(2,886,852)</u>	<u>(1,516,548)</u>	<u>84,854</u>
Net change in cash and cash equivalents	(698,805)	824,846	1,551,722
Cash and cash equivalents - beginning of year	2,448,363	1,623,517	71,795
Cash and cash equivalents - end of year	<u>\$ 1,749,558</u>	<u>\$ 2,448,363</u>	<u>\$ 1,623,517</u>
SUPPLEMENTAL DISCLOSURES OF NON-CASH ACTIVITIES			
Reduction in Tap Participation Fee liability resulting from remedies under the Arkansas River Agreement	\$ 53,317,500	\$ 11,737,300	\$ -
Mortgage payable and related party receivable recorded upon HP A&M default	-	-	9,550,200
Farm revenue allocated against the Tap Participation Fee liability and additional paid in capital thru August 3, 2012	-	-	189,700
	<u>\$ 53,317,500</u>	<u>\$ 11,737,300</u>	<u>\$ 9,739,900</u>

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
August 31, 2014, 2013 and 2012

NOTE 1 – ORGANIZATION

Pure Cycle Corporation (the “Company”) was incorporated in Delaware in 1976 and reincorporated in Colorado in 2008. The Company owns assets in the Denver, Colorado metropolitan area and in Southeast Colorado. The Company is currently using its water assets located in the Denver metropolitan area to provide wholesale water and wastewater services to customers located in the Denver metropolitan area. The Company is leasing its farm land in Southeast Colorado to area farmers.

The Company provides a full line of wholesale water and wastewater services which includes designing and constructing water and wastewater systems as well as operating and maintaining such systems. The Company’s business focus is to provide wholesale water and wastewater services, predominately to local governmental entities, which provide services to their end-use customers throughout the Denver metropolitan area as well as along the Colorado Front Range.

The Company believes it has sufficient working capital and financing sources to fund its operations for at least the next fiscal year. As of August 31, 2014, the Company had \$1.7 million of cash and cash equivalents and \$1.2 million of working capital.

The Company’s ability to generate working capital from its water and wastewater projects is dependent on its ability to successfully market its water, or in the event it is unsuccessful, to sell the underlying water assets. In the event increased sales are not achieved or the Company is unable to sell its water assets at a sufficient level, the Company may have to issue additional short or long-term debt or seek to sell additional shares of the Company’s common or preferred stock to generate sufficient working capital. There can be no assurance that the Company will be successful in marketing its water on terms that are acceptable to the Company.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements of the Company include the accounts of Pure Cycle Corporation and its majority-owned and controlled subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid debt instruments with original maturities of three months or less. The Company’s cash equivalents are comprised entirely of money market funds maintained at a high quality financial institution in an account which as of August 31, 2014 exceed federally insured limits. At various times during the year ended August 31, 2014, the Company’s main operating account exceeded federally insured limits.

Financial Instruments – Concentration of Credit Risk and Fair Value

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents. The Company places its cash equivalents with high quality financial institutions. At various times throughout the year ended August 31, 2014, cash deposits have exceeded federally insured limits. The Company historically invested its idle cash primarily in certificates of deposit, money market instruments, commercial paper obligations, corporate bonds and US government treasury obligations. To date, the Company has not experienced significant losses on any of these investments.

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
August 31, 2014, 2013 and 2012

Mortgages Payable and HP A&M Receivable

In conjunction with HP A&M defaulting on certain promissory notes in fiscal year 2012, the Company has the right to collect from HP A&M any amounts the Company spends to protect its interest from the defaulted notes. Accordingly the Company has recorded the entire amount of the HP A&M notes at default as well as expenses incurred to cure the defaults as a receivable from HP A&M less proceeds received from the sale of shares pledged by HP A&M pursuant to the Asset Purchase Agreement, dated May 10, 2006, between the Company and HP A&M (“The Arkansas River Agreement”). The receivable represents the amount of the defaulted promissory notes payable by HP A&M which were purchased by the Company and with respect to which the Company is pursuing remedies under the Arkansas River Agreement (as described in more detail in Note 4 – *Water and Land Assets*) over the next 12 months, plus expenses as noted above.

In the fiscal year 2013 the Company began acquiring the defaulted promissory notes that are payable by HP A&M using a combination of cash and promissory notes. The majority of the notes issued by the Company have a five-year term, bear interest at an annual rate of five percent and require semi-annual payments with a straight-line amortization schedule, (see Note 7 – *Long Term Debt and Operating Lease*).

Cash Flows

The Company paid \$239,200 and \$245,500 in interest during the fiscal years ended August 31, 2014 and 2013, respectively. The Company did not pay any interest during the fiscal year ended August 31, 2012.

The Company did not pay any income taxes during the fiscal years ended August 31, 2014, 2013 and 2012.

Trade Accounts Receivable

The Company records accounts receivable net of allowances for uncollectible accounts. Included in trade accounts receivable are balances due from farm operations. The Company recorded an allowance for uncollectible accounts in the amounts of \$26,300 and \$41,100 as of August 31, 2014 and 2013, respectively. The allowance for uncollectible accounts was determined based on specific review of all past due accounts.

Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the eventual use of the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Based on the Company’s procedures, the Company determined that land and water rights held for sale related to the Arkansas River Assets were impaired as of August 31, 2014, and the Company recorded an impairment of \$402,700. The Company determined that no impairment of such assets existed at August 31, 2013. The Company determined that its “Paradise Water Supply” asset (defined in Note 4 below) and land and water rights held for sale related to the Arkansas River Assets were impaired as of August 31, 2012. See further discussion in Note 4 below under sections “Paradise Water Supply” and “Arkansas River Assets”.

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

Costs to construct water and wastewater systems that meet the Company’s capitalization criteria are capitalized as incurred, including interest, and depreciated on a straight-line basis over their estimated useful lives of up to thirty years. The Company capitalizes design and construction costs related to construction activities and it capitalizes certain legal, engineering and permitting costs relating to the adjudication and improvement of its water assets.

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
August 31, 2014, 2013 and 2012

The Company depletes its water assets that are being utilized on the basis of units produced (i.e. thousands of gallons sold) divided by the total volume of water adjudicated in the water decrees.

Tap Participation Fee Liability and Imputed Interest Expense

The Tap Participation Fee liability (“TPF”), as described in Note 7 – *Long Term Debt and Operating Lease*, represents the discounted fair value of the amounts the Company estimates it will pay HP A&M pursuant to the Arkansas River Agreement. The Company imputes interest expense on the unpaid TPF using the effective interest method, over the estimated development period. The Company imputed interest of \$1.4 million, \$3.3 million and \$3.5 million during the years ended August 31, 2014, 2013 and 2012, respectively.

The TPF is due and payable once the Company has sold a water tap and received the consideration due for such water tap. The Company did not sell any water taps during the years ended August 31, 2014, 2013 or 2012. As of August 31, 2014, 2,184 water taps remain subject to the TPF.

Revenue Recognition

The Company generates revenues through two separate lines of businesses. Its revenues are derived through its Wholesale Water and Wastewater business and its Farming Operations, which are described below.

Wholesale Water and Wastewater business – The Company generates revenues through its wholesale water and wastewater segment predominately from three sources: (i) monthly wholesale water usage fees and wastewater service fees, (ii) one time water and wastewater tap fees, and construction fees, and (iii) consulting fees. Because these items are separately delivered, the Company accounts for each of the items separately, as described below.

- i) Monthly wholesale water and wastewater service fees – Monthly wholesale water usage charges are assessed to the Company’s customers based on actual metered usage each month plus a base monthly service fee assessed per single family equivalent (“SFE”) unit served. One SFE is a customer, whether residential, commercial or industrial, that imparts a demand on the Company’s water or wastewater systems similar to the demand of a family of four persons living in a single family house on a standard sized lot. One SFE is assumed to have a water demand of approximately 0.4 acre feet per year and to contribute wastewater flows of approximately 300 gallons per day. Water usage pricing uses a tiered pricing structure. The Company recognizes wholesale water usage revenues upon delivering water to its customers or its governmental customers’ end-use customers, as applicable. The water revenues recognized by the Company are shown net of royalties to the Land Board and, when applicable, amounts retained by the Rangeview Metropolitan District (the “District”).

The Company recognizes wastewater processing revenues monthly based on usage. The monthly wastewater service fees are shown net of amounts retained by the District. Amounts recognized for water and wastewater services during the fiscal years ended August 31, 2014, 2013 and 2012, are presented in the statements of operations. Costs of delivering water and providing wastewater service to customers are recognized as incurred.

The Company delivered 190.1 million, 69.2 million and 34.2 million gallons of water to customers during the fiscal years ended August 31, 2014, 2013 and 2012, respectively.

- ii) Water and wastewater tap fees and construction fees – Tap fees, also called system development fees, are received in advance, are non-refundable and are typically used to fund construction of certain facilities and defray the acquisition costs of obtaining water rights. Construction fees are fees used by the Company to construct assets that are typically required to be constructed by developers or home builders.

Proceeds from tap fees and construction fees are deferred upon receipt and recognized in income either upon completion of construction of infrastructure or ratably over time, depending on whether the Company owns the infrastructure constructed with the proceeds or a customer owns the infrastructure constructed with the proceeds.

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Tap and construction fees derived from agreements in which the Company will not own the assets constructed with the fees are recognized as revenue using the percentage-of-completion method. Costs of construction of the assets when the Company will not own the assets are recorded as construction costs.

Tap and construction fees derived from agreements for which the Company will own the infrastructure are recognized as revenues ratably over the estimated accounting service life of the facilities constructed, starting at completion of construction, which could be in excess of thirty years. Costs of construction of the assets when the Company will own the assets are capitalized and depreciated over their estimated economic lives.

From time to time the Company enters into water service agreements to provide water service to customers. The Company owns the facilities which store, treat, and deliver the water and amortizes the cost of these facilities over their useful lives. In each of the three fiscal years ended August 31, 2014, 2013 and 2012, the Company recognized \$14,300 of tap fee revenue. At August 31, 2014, \$313,300 of these tap fees are still deferred. The Company recognized \$41,500 of "Special Facilities" funding as revenue in each of the three fiscal years ended August 31, 2014, 2013, and 2012 respectively. As of August 31, 2014, the Company has deferred recognition of \$1.2 million of tap and construction fee revenue from customer agreements, which will be recognized as revenue ratably through 2016.

In addition to the tap fee revenues and the construction revenues, the Company also recorded interest income from Arapahoe County using the effective interest method. Pursuant to the Arapahoe County agreement, the County made payments to the Company totaling \$82,200 per year through 2013 for the construction of the Special Facilities at the Fairgrounds. These payments include interest at 6% per annum. In April 2013 the County paid the balance on the note. The Company recognized \$5,500 and \$19,200 of interest income from the County during the fiscal years ended August 31, 2013 and 2012, respectively.

In August 2012, the Company entered into an agreement with Front Range Pipeline which grants Front Range Pipeline easement rights for a period of three years to construct a pipeline for total consideration of \$28,700. As of August 31, 2014, the Company had \$9,300 in deferred revenue from Front Range Pipeline.

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

Agricultural Farming Operations – The Company leases its Arkansas River water and land to area farmers who actively farm the properties. Prior to August 3, 2012, pursuant to a property management agreement between HP A&M and the Company (the "Property Management Agreement"), HP A&M received a management fee equal to 100% of the income from the land and water leases. As a result, the Company presented its land and water lease income net of the management fees paid to HP A&M. Effective August 3, 2012, the Company terminated the Property Management Agreement due to a default by HP A&M on certain promissory notes secured by deeds of trust on the land and water purchased by the Company from HP A&M in 2006. Effective August 3, 2012, the Company manages the land and water leases and the income from the land and water leases became payable to the Company. Pursuant to the farm lease agreements, the Company bills the lessees semi-annually in March and November. The lease billings include minimum billings and adjustments based on actual water deliveries by the Fort Lyon Canal Company ("FLCC") or are based on crop yields. Subsequent to August 3, 2012, the Company records farm lease income ratably each month based on estimated annual lease income the Company anticipates collecting from its land and water leases. The Company recorded these amounts as receivables, less an estimated allowance for uncollectible accounts. The allowance as of August 31, 2014, was determined by the Company's specific review of all past due accounts. The Company has recorded allowances for doubtful accounts totaling \$26,300 and \$41,100 as of August 31, 2014 and 2013, respectively. As of August 31, 2014 and 2013 the Company has accrued \$256,500 and \$397,300, respectively, of farm income related to billings for future periods. The Company manages the farm lease business as a separate line of business from the wholesale water and wastewater business.

Royalty and other obligations

Revenues from the sale of "Export Water" are shown net of royalties payable to the Land Board. Revenues from the sale of water on the "Lowry Range" are shown net of the royalties to the Land Board and the amounts retained by

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the District. See further description of “Export Water” and the “Lowry Range” in Note 4 under “Rangeview Water Supply and Water System”.

Oil and Gas Lease Payments

As further described in Note 4 below, on March 10, 2011, the Company entered into a Paid-Up Oil and Gas Lease (the “O&G Lease”) and a Surface Use and Damage Agreement (the “Surface Use Agreement”) with Anadarko E&P Company, L.P. (“Anadarko”), a wholly owned subsidiary of Anadarko Petroleum Company. Pursuant to the O&G Lease on March 10, 2011, the Company received an up-front payment of \$1,243,400 from Anadarko for the purpose of exploring for, developing, producing and marketing oil and gas on approximately 634 acres of mineral estate owned by the Company at its Sky Ranch property. In December 2012 the O&G Lease was purchased by a wholly owned subsidiary of ConocoPhillips Company. The Company received an additional payment of \$1,243,400 during February 2014 to extend the O&G Lease an additional two years through February 2016, which will be recognized as income on a straight-line basis over two years (the extension term of the O&G Lease). In addition, during the fiscal years ended August 31, 2014 and 2013, the Company received up-front payments of \$72,000 and \$12,540, respectively, for the purpose of exploring for, developing, producing, and marketing oil and gas on 40 acres of mineral estate the Company owns adjacent to the Lowry Range (the “Rangeview Lease”). The Company recognizes the up-front payments on a straight-line basis over the terms of the respective leases. During the years ended August 31, 2014, 2013 and 2012, the Company recognized \$525,400, \$416,000, and \$423,000, respectively, of income related to the up-front payments received pursuant to these leases.

As of August 31, 2014, the Company has deferred recognition of \$1,025,500 of income related to the O&G Lease, which will be recognized into income ratably through July 2017.

Share-based Compensation

The Company maintains a stock option plan for the benefit of its employees and directors. The Company records share-based compensation costs which are measured at the grant date based on the fair value of the award and are recognized as expense over the applicable vesting period of the stock award using the straight-line method. The Company has adopted the alternative transition method for calculating the tax effects of share-based compensation which allows for a simplified method of calculating the tax effects of employee share-based compensation. Because the Company has a full valuation allowance on its deferred tax assets, the granting and exercise of stock options during the fiscal years ended August 31, 2014 and 2013 had no impact on the income tax provisions.

The Company recognized \$251,900, \$66,800, and \$54,600 of share-based compensation expenses during the fiscal years ended August 31, 2014, 2013 and 2012, respectively.

Income Taxes

The Company uses a “more-likely-than-not” threshold for the recognition and de-recognition of tax positions, including any potential interest and penalties relating to tax positions taken by the Company. The Company does not have any significant unrecognized tax benefits as of August 31, 2014.

The Company files income tax returns with the Internal Revenue Service and the State of Colorado. The tax years that remain subject to examination are fiscal 2010 through fiscal 2013. The Company does not believe there will be any material changes in its unrecognized tax positions over the next twelve months.

The Company’s policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. At August 31, 2014, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the fiscal years ended August 31, 2014, 2013 or 2012.

Loss per Common Share

Loss per common share is computed by dividing net loss by the weighted average number of shares outstanding during each period. Common stock options and warrants aggregating 315,100, 347,600, and 215,100 common share

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equivalents as of August 31, 2014, 2013 and 2012, respectively, have been excluded from the calculation of loss per common share as their effect is anti-dilutive.

Recently Issued Accounting Pronouncements

The Company continually assesses any new accounting pronouncements to determine their applicability. Where it is determined that a new accounting pronouncement affects the Company's financial reporting, the Company undertakes a study to determine the consequence of the change to its financial statements and assures that there are proper controls in place to ascertain that the Company's financials properly reflect the change. A variety of proposed or otherwise potential accounting standards are currently under study by standard-setting organizations and various regulatory agencies. Because of the tentative and preliminary nature of these proposed standards, the Company has not determined whether implementation of such proposed standards would be material to the Company's financial statements. New pronouncements assessed by the Company recently are discussed below:

In May 2014, FASB issued ASU No. 2014-09 "Revenue from Contracts from Customers," which supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)," and requires entities to recognize revenue in a way that depicts the transfer of potential goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to the exchange for those goods or services. ASU 2014-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and is to be applied retrospectively, with early adoption not permitted. The Company is currently evaluating the new standard.

In August 2014, FASB issued ASU No. 2014-15 "Preparation of Financial Statements - Going Concern (Subtopic 205-40), Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." ASU 2014-15 is intended to define management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Specifically, ASU 2014-15 provides a definition of the term substantial doubt and requires an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). It also requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans and requires an express statement and other disclosures when substantial doubt is not alleviated. The new standard will be effective for reporting periods beginning after December 15, 2016, with early adoption permitted. The Company will evaluate the going concern considerations in this ASU, however, at the current period, management does not believe that it has met conditions which would subject these financial statements for additional disclosure.

NOTE 3 – FAIR VALUE MEASUREMENTS

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

Level 1 — Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. The Company had none of these instruments at August 31, 2014 or 2013.

Level 2 — Valuations for assets and liabilities obtained from readily available pricing sources via independent providers for market transactions involving similar assets or liabilities. The Company had no Level 2 assets or liabilities at August 31, 2014 or 2013.

Level 3 — Valuations for assets and liabilities that are derived from other valuation methodologies, including discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities. The Company had one Level 3 liability at August 31, 2014 and 2013, the Tap Participation Fee liability, which is described in greater detail in Note 2 – *Summary of Significant Accounting Policies* and Note 7 – *Long-Term Debt And Operating Lease*.

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

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The Company's non-financial assets measured at fair value on a non-recurring basis consist of its investments in water and water systems and other long-lived assets held for sale. See Note 4 – *Water and Land Assets* for impairment of water rights and land with the associated water rights held for sale.

Level 3 Liability – Tap Participation Fee. The Company's Tap Participation Fee liability is the Company's only financial liability measured on a non-recurring basis. The Tap Participation Fee liability is valued by projecting new home development in the Company's targeted service area over an estimated development period. Due to the long-term nature of the Tap Participation Fee, the valuation of the Tap Participation Fee is not sensitive to minor changes. See further description of the Tap Participation Fee in Note 7 – *Long-Term Debt and Operating Lease*.

The following table provides information on the assets and liabilities measured at fair value as of August 31, 2014:

	Fair Value	Cost / Other Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Unrealized Gains and Losses
Tap Participation Fee	\$ 7,935,300	\$ 7,935,300	\$ -	\$ -	\$ 7,935,300	\$ -

Although not required, the Company deems the following table, which presents the changes in the Tap Participation Fee for the year ended August 31, 2014, to be helpful to the users of its financial statements:

	Gross Estimated Tap Participation Fee Liability	Tap Participation Fee Reported Liability	Discount - to be imputed as interest expense in future periods
Balance at September 1, 2013	\$ 102,681,900	\$ 59,807,300	\$42,874,600
Total gains and losses (realized and unrealized):			
Imputed interest recorded as "Other Expense"	-	1,445,500	(1,445,500)
Purchases, sales, issuances, payments, and settlements	(90,643,600)	(53,317,500)	(37,326,100)
Transfers in and/or out of Level 3	-	-	-
Balance at August 31, 2014	<u>\$ 12,038,300</u>	<u>\$ 7,935,300</u>	<u>\$ 4,103,000</u>

The methodologies for estimating the fair value of financial assets and liabilities that are measured at fair value are discussed above. The methodologies for other financial assets and liabilities are discussed below.

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

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

Long-term Financial Liabilities: The Comprehensive Amendment Agreement No. 1 the "CAA" is comprised of a recorded balance and an off-balance sheet or "contingent" obligation associated with the Company's acquisition of its "Rangeview Water Supply" (defined in Note 4 below). The amount payable is a fixed amount but is repayable only upon the sale of "Export Water" (defined in Note 4 below). Because of the uncertainty of the sale of Export Water, the Company has determined that the contingent portion of the CAA does not have a determinable fair value. The CAA is described further in Note 5 – *Participating Interests in Export Water*.

The recorded balance of the "Tap Participation Fee" liability (as described below) is its estimated fair value determined by projecting new home development in the Company's targeted service area over an estimated development period.

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Notes Receivable – Related Party: The fair value of the Note Receivable – Related Party is not practicable to estimate due to the related party nature of the underlying transactions.

Receivable from HP A&M: In conjunction with HP A&M defaulting on certain promissory notes, the Company has the right to collect from HP A&M any amounts the Company spends to cure the defaulted notes. Accordingly the Company has recorded the entire amount of the HP A&M notes as a receivable from HP A&M. Due to the fact that HP A&M was a related party the fair value of the accounts receivable is not practical to determine. As of August 31, 2013 the receivable was deemed current as the notes were in default and considered collectible upon demand. As of August 31, 2014 the notes have been through foreclosure and are now considered long-term as they are subject to litigation as discussed further in Note 12 – *Litigation Loss Contingencies*.

Mortgages Payable: During fiscal 2013, the Company began acquiring the defaulted and non-defaulted promissory notes that are payable by HP A&M in exchange for a combination of cash and promissory notes. The majority of the notes issued by the Company have a five-year term, bear interest at an annual rate of five percent (5%) and require semi-annual payments with a straight-line amortization schedule. The carrying value of the notes payable approximate the fair value as the rates are comparable to market rates.

Off-Balance Sheet Instruments: The Company’s off-balance sheet instruments consist entirely of the contingent portion of the CAA. Because repayment of this portion of the CAA is contingent on the sale of Export Water, which is not reasonably estimable, the Company has determined that the contingent portion of the CAA does not have a determinable fair value. See further discussion in Note 5 – *Participating Interests In Export Water*.

NOTE 4 – WATER AND LAND ASSETS

The Company’s water and water systems consist of the following approximate costs and accumulated depreciation and depletion as of August 31:

	August 31, 2014		August 31, 2013	
	Costs	Accumulated Depreciation and Depletion	Costs	Accumulated Depreciation and Depletion
Arkansas River assets	\$ 67,746,400	\$ (1,488,600)	\$ 69,112,300	\$ (1,487,700)
Rangeview water supply	14,444,600	(8,400)	14,667,000	(7,700)
Sky Ranch water rights and other costs	6,004,000	(93,000)	3,915,100	(79,800)
Fairgrounds water and water system	2,899,900	(710,600)	2,899,900	(622,600)
Rangeview water system	1,148,200	(77,900)	167,700	(72,800)
Water supply – other	1,050,200	(90,900)	43,200	(22,400)
Totals	<u>93,293,300</u>	<u>(2,469,400)</u>	<u>90,805,200</u>	<u>(2,293,000)</u>
Net investments in water and water systems	<u>\$ 90,823,900</u>		<u>\$ 88,512,200</u>	

Depletion and Depreciation

The Company recorded a \$4,400 depletion charge during the fiscal year ended August 31, 2014 and a \$500 of depletion charge during each of the two fiscal years ended August 31, 2013 and 2012, respectively. During the fiscal year ended August 31, 2014 this related to the Rangeview and Sky Ranch Water supplies (defined below) and during the fiscal years ended August 31, 2013 and 2012, respectively, this related entirely to the Rangeview Water Supply. No depletion is taken against the Arkansas River (defined below) because the water located at this location is not yet being utilized for their intended purpose as of August 31, 2014.

The Company recorded \$192,200, \$310,800 and \$308,700 of depreciation expense in each of the fiscal years ended August 31, 2014, 2013 and 2012, respectively. These figures include depreciation for other equipment not included in the table above.

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Arkansas River Assets

Arkansas River Water – The Company owns approximately 51,000 acre feet of senior water rights in the Arkansas River and its tributaries in Southeastern Colorado. The Company anticipates that of this, 34,000 acre feet may be available for non-agricultural uses along the front range of Colorado sometime in the future. The Company acquired its Arkansas River assets from HP A&M pursuant to the Arkansas River Agreement entered into on May 10, 2006.

In order to utilize the Arkansas River water in the Company's service areas, the Company will be required to convert this water to municipal and industrial uses. Change of water use must be done through the Colorado water court and several conditions must be present prior to the water court granting an application for transfer of a water right. A transfer case would be expected to include the following provisions:

- (i) a provision of anti-speculation in which the applicant must have contractual obligations to provide water service to customers prior to the water court ruling on the transfer of a water right,
- (ii) the applicant can only transfer the "consumptive use" portion of its water rights (the Company expects to face opposition to any consumptive use calculation of the historic agricultural uses of its water),
- (iii) applicants likely would be required to mitigate the loss of tax base in the basin of origin,
- (iv) applicants would likely have re-vegetation requirements to restore irrigated soils to non-irrigated, and
- (v) applicants would be required to meet water quality measures which would be included in the cost of transferring the water rights.

The value of the assets was recorded based on the determined fair value of the consideration paid at the acquisition date, because the value of the consideration was deemed a more reliable criterion of value than the value of the acquired assets. The consideration paid was comprised of equity (3.0 million shares of the Company's common stock) and the Tap Participation Fee. Because the estimated value of the consideration paid was less than the total estimated fair value of the assets acquired by the Company, the relative values assigned to the assets were ratably reduced. For a discussion of promissory notes owed by HP A&M to third parties which are secured by the Company's Arkansas River water rights, see "Arkansas River Land" section below, Note 7 – *Long Term Debt and Operating Lease*, and Note 15 – *Subsequent Events*.

Fort Lyon Canal Company ("FLCC") Shares – The Arkansas River water rights are represented by 18,656 shares of the FLCC, which is a non-profit mutual ditch company established in the late 1800's that operates and maintains the 110 mile Fort Lyon Canal between La Junta, Colorado and Lamar, Colorado. The shares in the FLCC represent the amount of water the Company owns in the Fort Lyon Canal.

Pursuant to the Arkansas River Agreement, the Company pledged to HP A&M: (i) one-half of the FLCC shares purchased by the Company, (ii) all shares of FLCC hereafter issued to the Company by means of any dividend or distribution in respect of the shares pledged thereunder together with the shares identified in (i), the "Company's Pledged Shares", (iii) the certificates representing the Company's Pledged Shares, (iv) the land associated with the water represented by the Company's Pledged Shares, and (v) all rights to money or property which the Company now has or hereafter acquires in respect of the Company's Pledged Shares. This pledge agreement will terminate upon payment of the Tap Participation Fee.

Arkansas River Land – The Company owns approximately 14,900 acres of real property which is being used for agricultural purposes and was acquired from HP A&M in 2006 in connection with the water acquisition described above. The land is located in the counties of Bent, Otero and Prowers in southern Colorado. The Company also owns certain contract rights, tangible personal property, mineral rights, and other water interests related to the Arkansas River water and land.

The land owned by the Company is divided into separate properties, each of which is being leased to area farmers. Most of the operating leases expire on December 31, 2014, while the remaining leases have a variety of expiration dates. Beginning September 1, 2011, until the Property Management Agreement was terminated in 2012, the Company allocated 26.9% (calculated pursuant to the Property Management Agreement based on consideration paid

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to HP A&M since the signing of the Arkansas River Agreement) of the net revenues paid to HP A&M (which is the lease payments HP A&M retained less expenses for employees, reasonable overhead and actual expenses paid to manage the farm leases) against the Tap Participation Fee liability.

The Property Management Agreement was terminated on August 3, 2012 due to defaults by HP A&M on certain promissory notes secured by deeds of trust on the Company's land and water. On July 23, 2012, the Company notified all the farm lessees that HP A&M had defaulted on its obligations. The lessees were informed that all lease payments would be billed directly by and paid directly to the Company from the date of the notice forward. All other terms of the leases remained unchanged. Under the farm lease agreements, the farmers are billed twice a year in November and March. The Company received lease income from farm leases of approximately \$1,068,000, \$1,241,900 and \$71,100 (recorded as revenue for fiscal 2014 and 2013 and other income for fiscal 2012) for the fiscal years ended August 31, 2014, 2013 and 2012, respectively. The allocation of 26.9% of the net revenues against the Tap Participation Fee, the termination of the Property Management and the defaults by HP A&M are described in greater detail in Note 7 – *Long-Term Debt and Operating Lease*.

Land and Water Shares Held for Sale

During fiscal year end 2012, management decided to sell certain farms in order to have the cash flow sufficient to acquire the notes defaulted upon by HP A&M and to meet the future obligations on the promissory notes the Company intended is issue as consideration to purchase the notes owed by HP A&M. Management anticipated selling approximately 1,603 acres of land along with 3,397 FLCC shares associated with this land. The net book value of the assets held for sale prior to being impaired at August 31, 2012 was \$12.2 million. The negotiated sales price for these assets was \$5.7 million which resulted in a loss of \$6.5 million, which was expensed in fiscal 2012.

Through August 31, 2014, the Company completed sales of approximately 1,886 acres of land and 2,982 FLCC shares associated with the land; and, in November 2014, completed sales of approximately 299 acres of land along with 239 FLCC shares associated with the land. Management believes that the November 2014 sale completes the sales cycle related to the land held for sale. Due to modifications of the actual acreage sold and the number of FLCC shares associated with the land sold, a gain on the transaction of approximately \$1.3 million was recorded during the fourth quarter of fiscal 2014.

In addition, management identified an additional 640 acres of land and 512 FLCC shares associated with the land as held for sale in order to have sufficient cash available to continue to meet future obligations on the promissory notes the Company issued to purchase the defaulted notes owed by HP A&M and to continue to fund water system expansions. The net book value of the assets identified as held for sale was \$1.9 million prior to designation as held for sale. The anticipated sales price for these assets is \$1.5 million based on recent sales transactions which resulted in a loss of approximately \$400,000, which is expensed in fiscal 2014.

Rangeview Water Supply and Water System

The "Rangeview Water Supply" consists of 25,050 acre feet and is a combination of tributary surface water and groundwater rights along with certain storage rights associated with the Lowry Range, a 27,000-acre property owned by the Land Board located 16 miles southeast of Denver, Colorado. The \$14.4 million on the Company's balance sheet as of August 31, 2014, represents the costs of assets acquired or facilities constructed to extend water service to customers located on and off the Lowry Range. The recorded costs of the Rangeview Water Supply include payments to the sellers of the Rangeview Water Supply, design and construction costs and certain direct costs related to improvements to the asset including legal and engineering fees.

The Company acquired the Rangeview Water Supply beginning in 1996 when:

- (i) The District entered into the 2014 Amended and Restated Lease Agreement with the Land Board, which owns the Lowry Range;
- (ii) The Company entered into the Agreement for Sale of Export Water with the District, a quasi-municipal political subdivision of the State of Colorado;

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- (iii) The Company entered into the 2014 Amended and Restated Service Agreement with the District for the provision of water service to the Lowry Range; and
- (iv) In 1997, the Company entered into the Wastewater Service Agreement with the District for the provision of wastewater service to the District's service area.

In July 2014 the Company and the District amended the lease and entered into the 2014 Amended and Restated Lease with the Land Board and an Amended and Restated Service Agreement with the District. Collectively, the foregoing agreements, as amended, are referred to as the "Rangeview Water Agreements."

Pursuant to the Rangeview Water Agreements, the Company owns 11,650 acre feet groundwater which can be exported off the Lowry Range to serve area users (referred to as "Export Water"). The Company also has the right to exchange an aggregate gross volume of 165,000 acre feet of groundwater for 1,650 acre feet per year of adjudicated surface water and to use this surface water as Export Water. Additionally, the Company has the exclusive right to provide water and wastewater service, through 2081, to all water users on the Lowry Range, and the right to develop an additional 13,400 acre feet of groundwater and 3,300 acre feet of adjudicated surface water (subject to the exchange for Export Water) to serve customers either on or off the Lowry Range. The Rangeview Water Agreements also provide for the Company to use surface reservoir storage capacity in providing water service to customers both on and off the Lowry Range.

Services on the Lowry Range – Pursuant to the Rangeview Water Agreements, the Company designs, finances, constructs, operates and maintains the District's water and wastewater systems to provide service to the District's customers on the Lowry Range. The Company will operate both the water and the wastewater systems during the contract period and the District owns both systems. After 2081, ownership of the water system will revert to the Land Board, with the District retaining ownership of the wastewater system.

Rates and charges for all water and wastewater services on the Lowry Range, including tap fees and usage or monthly fees, are governed by the terms of the Rangeview Water Agreements. Rates and charges are required to be less than the average of similar rates and charges of three surrounding municipal water and wastewater service providers, which are reassessed annually. Pursuant to the Rangeview Water Agreements the Land Board receives a 10% or 12% of gross revenues from the sale or disposition of the water depending on the purchaser of the water, except that the royalty on tap fees shall be 2%. The Company will also pay the Land Board a minimum annual water production fee, estimated to be approximately \$140,000, which is to be credited against future royalties. The District retains 2% of the remaining gross revenues and the Company receives 98% of the remaining gross revenues after the Land Board Royalty. The Land Board does not receive a royalty on wastewater fees. The Company receives 100% of the District's wastewater tap fees and 90% of the District's wastewater usage fees (the District retains the other 10%).

Export Water – The Company owns the Export Water and uses and intends to use it to provide water and wastewater services to customers off the Lowry Range. The Company will own all facilities required to extend water and wastewater services using its Export Water. The Company anticipates contracting with third parties for the construction of these facilities. If the Company sells water, the Company is required to pay royalties to the Land Board ranging from 10% - 12% of gross revenues.

The County Fairgrounds Water and Water System

The Company owns 321 acre feet of groundwater purchased pursuant to the County Agreement. The Company plans to use this water in conjunction with its Rangeview Water Rights in providing water to areas outside the Lowry Range. The \$2.9 million of capitalized costs includes the costs to construct various Wholesale and Special Facilities, including a new deep water well, a 500,000 gallon water tank and pipelines to transport water to the Fairgrounds.

Sky Ranch

In 2010 the Company purchased approximately 931 acres of undeveloped land known as Sky Ranch. The property includes the rights to 820 acre feet of water.

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Total consideration for the land and water included the \$7.0 million purchase price, plus direct costs and fees of \$554,100. The Company allocated the total acquisition cost to the land and water rights based on estimates of each asset's respective fair value.

At August 31, 2014, Sky Ranch Metropolitan District #5 owed the Company approximately \$50,900 to pay for various advances to pay for costs associated with establishing and operating the district. The Company anticipates these costs will be recovered through future revenues from property tax assessments.

O&G Lease – On March 10, 2011, the Company entered into the O&G Lease and the Surface Use Agreement with Anadarko. Pursuant to the O&G Lease, the Company received an up-front payment of \$1,243,400 from Anadarko for the purpose of exploring for, developing, producing and marketing oil and gas on 634 acres of mineral estate owned by the Company at its Sky Ranch property. The Company also received \$9,000 in surface use and damage payments. In December of 2012 the O&G Lease was purchased by a wholly owned subsidiary of ConocoPhillips Company. The Company received an additional payment of \$1,243,400 during February 2014 to extend the O&G Lease an additional two years through February 2016.

Paradise Water Supply

During fiscal 2012 the Company deemed the Paradise Water Supply to be fully impaired and an impairment of \$5.5 million was recorded in the fiscal 2012 financial statements. During August 2014 the Company completed the disposition of the Paradise Water Supply.

NOTE 5 – PARTICIPATING INTERESTS IN EXPORT WATER

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

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

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

From time to time the Company repurchased various portions of the CAA obligations in priority. In July 2014, the Land Board relinquished its approximately \$2.4 million of CAA interests to the Company as part of the settlement of the 2011 lawsuit filed by the Company and the District against the Land Board. As a result, during the fourth quarter of the fiscal year ended August 31, 2014 the Company recorded a gain on the extinguishment of participating interests of the CAA of approximately \$832,100. The Company now has the right to retain an additional \$2.4 million of the initial \$31.8 million of proceeds from the sale of Export Water. The Company did not make any CAA acquisitions during the fiscal years ended August 31, 2013 or 2012.

As a result of the acquisitions, the relinquishment, and due to the sale of Export Water, as detailed in the table below, the remaining potential third party obligation at August 31, 2014, is approximately \$1 million:

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	Export Water Proceeds Received	Initial Export Water Proceeds to Pure Cycle	Total Potential Third party Obligation	Participating Interests Liability	Contingency
Original balances	\$ –	\$ 218,500	\$ 31,807,700	\$ 11,090,600	\$ 20,717,100
<i>Activity from inception until August 31, 2012:</i>					
Acquisitions	–	28,077,500	(28,077,500)	(9,790,000)	(18,287,500)
<i>Option payments - Sky Ranch</i>					
and The Hills at Sky Ranch	110,400	(42,300)	(68,100)	(23,800)	(44,300)
Arapahoe County tap fees *	533,000	(373,100)	(159,900)	(55,800)	(104,100)
Export Water sale payments	111,300	(77,900)	(33,400)	(12,100)	(21,300)
Balance at August 31, 2012	754,700	27,802,700	3,468,800	1,208,900	2,259,900
<i>Fiscal 2013 activity:</i>					
Export Water sale payments	158,000	(110,600)	(47,400)	(16,000)	(31,400)
Balance at August 31, 2013	912,700	27,692,100	3,421,400	1,192,900	2,228,500
<i>Fiscal 2014 activity:</i>					
Export Water sale payments	91,600	(73,700)	(17,900)	(6,200)	(11,700)
Relinquishment		2,386,400	(2,386,400)	(832,100)	(1,554,300)
Balance at August 31, 2014	\$ 1,004,300	\$ 30,004,800	\$ 1,017,100	\$ 354,600	\$ 662,500

* The Arapahoe County tap fees are less \$34,522 in royalties paid to the Land Board.

The CAA includes contractually established priorities which call for payments to CAA holders in order of their priority. This means the first payees receive their full payment before the next priority level receives any payment and so on until full repayment. The Company will receive approximately \$6.2 million of the first priority payout (the remaining entire first priority payout totals approximately \$7 million as of August 31, 2014).

NOTE 6 – ACCRUED LIABILITIES

At August 31, 2014, the Company had accrued liabilities of \$257,900, of which \$99,700 was for estimated property taxes, \$59,500 was for professional fees, \$22,400 for prepaid farm lease payments and the remaining \$76,300 was related to operating payables.

At August 31, 2013, the Company had accrued liabilities of \$264,700, of which \$156,200 was for estimated property taxes, \$56,700 was for professional fees, \$30,300 for prepaid farm lease payments and the remaining \$21,600 was related to operating payables.

NOTE 7 – LONG-TERM DEBT AND OPERATING LEASE

As of August 31, 2014, the Company is subject to mortgages with contractual maturity dates as described below.

The Participating Interest in Export Water supply and the Tap Participation Fee payable to HP A&M are obligations of the Company that have no scheduled maturity dates. Therefore, these liabilities are not disclosed in tabular format. However, the Participating Interest in Export Water supply is described in Note 5 – *Participating Interests in Export Water* and the Tap Participation Fee is described below in section “Tap Participation Fee Payable to HP A&M”.

Tap Participation Fee Payable to HP A&M

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

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Initially the obligation was to pay 10% of the Company's gross proceeds, or the equivalent thereof, from the sale of 40,000 water taps sold after the date of the Arkansas River Agreement. The 40,000 water taps were reduced to 2,184 water taps as a result of (i) sales of Arkansas River Valley land in 2006 and 2009, (ii) the sale of unutilized water rights owned by the Company in the Arkansas River Valley in 2007, (iii) the election made by HP A&M, effective September 1, 2011, pursuant to the Arkansas River Agreement, to increase the TPF percentage from 10% to 20%, and to take a corresponding 50% reduction in the number of taps subject to the TPF, (iv) the allocation of 26.9% of the Net Revenues (defined as all lease and related income received from the farms less employee expenses, direct expenses for managing the leases and a reasonable overhead allocation) received by HP A&M from management of the farm leasing operations from September 1, 2011 to August 3, 2012 prior to termination of the Property Management Agreement, and (v) the reduction of 17,243 taps as the result of foreclosures on certain farms pursuant to the remedies outlined in the Arkansas River Agreement (2,233 in fiscal 2013 and 15,010 in fiscal 2014).

The fair value of the TPF liability is an estimate prepared by management of the Company. The fair value of the liability is based on discounted estimated cash flows subject to the TPF calculated by projecting future annual water tap sales for the number of taps subject to the TPF at the date of valuation. Future cash flows from water tap sales are estimated by utilizing the following historical information, where available:

- New homes constructed in the area known as the 11-county "Front Range" of Colorado from the 1980's through the valuation date. The Company utilized data for this length of time to provide development information over many economic cycles because the Company anticipates development in its targeted service area to encompass many economic cycles over the development period.
- New home construction patterns for large master planned housing developments along the Front Range. The Company utilized this information because these developments are deemed comparable to projects anticipated to be constructed in the Company's targeted service area (i.e. these master planned communities were located in predominately undeveloped areas on the outskirts of the Front Range).
- Population growth rates for Colorado and the Front Range. Population growth rates were utilized to predict anticipated growth along the Front Range, which was used to predict an estimated number of new homes necessary to house the increased population.
- The Consumer Price Index since the 1980's, which was utilized to project estimated future water tap fees.

Utilizing this historical information, the Company projected an estimated new home development pattern in its targeted service area sufficient to cover the sale of the water taps subject to the TPF at the date of the revaluation, August 31, 2014. The Company revalued the TPF payable as of August 31, 2014 and 2013 due to the reduction of taps subject to the TPF as a result of the exercise of remedies under the Arkansas River Agreement. The estimated proceeds generated from the sale of those water taps resulted in estimated payments to HP A&M over the life of the projected development period of \$12 million, which is a decrease of \$90.7 million from the previous valuation completed at August 31, 2013 (\$102.7 million). The estimated proceeds as of August 31, 2013 was estimated to be \$102.7 million, a decrease of \$17.9 million from the previous valuation in fiscal 2012. The estimated payments to HP A&M are then discounted to the current valuation date and the difference between the amount reflected on the Company's balance sheet at the valuation date and the total estimated payments is imputed as interest expense over the estimated development time using the effective interest method. The implied interest rate for the most recent valuation was 6.6%.

Actual new home development in the Company's service area and actual future tap fees inevitably will vary significantly from the Company's estimates, which could have a material impact on the Company's consolidated financial statements. An important component in the Company's estimate of the value of the TPF, which is based on historical trends, is that the Company reasonably expects water tap fees to continue to increase in the coming years. Tap fees are market based and the continued increase in tap fees reflects, among other things, the increasing costs to acquire and develop new water supplies. Tap fees thus are partially indicative of the increasing value of the Company's water assets. The Company continues to assess the value of the TPF liability and updates its valuation analysis whenever events or circumstances indicate the assumptions used to estimate the value of the liability have changed materially. The difference between the net present value and the estimated realizable value will be imputed as interest expense using the effective interest method over the estimated development period utilized in

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the valuation of the TPF. Through August 31, 2014, \$27.5 million of interest has been imputed since the acquisition date, recorded using the effective interest method.

The Company's agreement with HP A&M provides for a reduction of the number of water taps subject to the TPF payable to HP A&M in the event the farms or water rights are subject to foreclosure proceedings or other risks of loss. During fiscal year 2013, four of the farms and one FLCC certificate representing water rights only, collectively including 1,216 FLCC shares, were foreclosed resulting in a reduction of the number of taps subject to the TPF by 2,233 taps (approximately \$11.7 million of TPF), leaving 17,194 taps (approximately \$59.8 million of TPF), subject to the TPF. During fiscal year 2014, an additional 31 farms and two FLCC certificate representing water rights only, collectively including 8,174 FLCC shares, were foreclosed resulting in a reduction of the number of taps subject to the TPF by an additional 15,113 taps (approximately \$53.3 million of the TPF), leaving 2,184 taps (approximately \$7.9 million of TPF), subject to the TPF. The Company recorded the decreases in the TPF payable as an equity transaction due to the related party nature of the original transaction.

Subsequent to August 31, 2014, an additional 981 FLCC shares, were foreclosed resulting in a reduction of the number of taps subject to the TPF by an additional 1,801 taps (approximately \$6.2 million of the TPF), leaving 383 taps (approximately \$1.7 million) subject to the TPF.

Promissory Notes Payable by HP A&M in default

Approximately 60 of the 80 properties the Company originally acquired from HP A&M were subject to outstanding promissory notes payable to third parties that were secured by deeds of trust on the Company's properties and water rights, as well as mineral interests. HP A&M has now defaulted on all of the promissory notes and informed the Company that it does not intend to pay any of the amounts owed. HP A&M owed approximately \$9.6 million of principal and accrued interest as of September 1, 2012. These promissory notes were secured by approximately 14,000 acres of land and 16,882 FLCC shares representing water rights owned by the Company.

On July 2, 2012, the Company formally notified HP A&M that its failure to pay the promissory notes constituted an Event of Default under the Seller Pledge Agreement (as defined below) and a default of a material covenant under the Arkansas River Agreement. The Company informed HP A&M that unless such defaults were cured within thirty days, the Property Management Agreement would be terminated and the Company would proceed to exercise certain rights and remedies under the Arkansas River Agreement, the Seller Pledge Agreement, and the Property Management Agreement to protect its assets. The Company's remedies at law and under the Arkansas River Agreement and related agreements include, but are not limited to, the right to (i) foreclose on 1,500,000 shares of Pure Cycle common stock issued to HP A&M and the proceeds therefrom (the "Pledged Shares") which were pledged by HP A&M pursuant to a pledge agreement (the "Seller Pledge Agreement") to secure the payment and performance by HP A&M of the promissory notes described above; (ii) reduce the Tap Participation Fee; (iii) terminate the Property Management Agreement; and (iv) recover damages caused by the defaults, including certain costs and expenses, including attorneys' fees.

On August 3, 2012, the Company formally terminated the Property Management Agreement. On September 27, 2012, the Pledged Shares were sold at public auction in a foreclosure sale for \$2.35 per share, yielding approximately \$3.42 million of proceeds to the Company (net of fees of \$110,000). Pursuant to the Arkansas River Agreement, the Company is reducing the Tap Participation Fee and is entitled to recover damages caused by the defaults, including certain costs and expenses, including attorney fees. The Company is currently pursuing its remedies and will continue to pursue such remedies over the next 12 months.

To protect its land and water interests, during the fiscal years ended August 31, 2014 and 2013, the Company purchased approximately \$9.4 million of the \$9.6 million notes payable by HP A&M. The remaining note was purchased by an entity controlled by the majority owner of HP A&M. HP A&M continues to be liable for making the required payments on the notes, and the Company is pursuing remedies to recover the costs and expenses, including attorneys' fees, incurred by the Company in protecting the rights and title to the land and water rights securing the notes payable by HP A&M, including the costs incurred in purchasing the notes defaulted on by HP A&M. The amount owed on the outstanding notes was approximately \$5 million, including accrued interest of \$80,800, approximately \$7.9 million, including accrued interest of \$122,000, and \$9.6 million at August 31, 2014, August 31, 2013 and August 31, 2012, respectively.

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Future Maturities

Mortgage notes payable, mainly bear interest at 5%, 5 year term; one note in amount of \$1.75 million had 20 year term	4,958,200
Less: current portion	(926,000)
Total long-term mortgage payable	<u>\$ 4,032,200</u>

Future Maturities	
2015	926,000
2016	892,100
2017	937,600
2018	615,000
2019	123,500
Post 2019	<u>1,464,000</u>
Total	<u>\$ 4,958,200</u>

Subsequent to the Company's fiscal year-end the Company borrowed approximately \$4.4 million as described in Note 15 – *Subsequent Events*. A portion of this financing will be used to pay down existing mortgages and will result in a change to the future maturities.

Operating Lease

Effective January 2013, the Company entered into an operating lease for 1,200 square feet of office space. The lease has a two year term with payments of approximately \$1,530 per month and expires in December 2014.

NOTE 8 – SHAREHOLDERS' EQUITY

Preferred Stock

The Company's non-voting Series B Preferred Stock has a preference in liquidation of \$1.00 per share less any dividends previously paid. Additionally, the Series B Preferred Stock is redeemable at the discretion of the Company for \$1.00 per share less any dividends previously paid. In the event that the Company's proceeds from sale or disposition of Export Water rights exceed \$36,026,232, the Series B Preferred Stock holders will receive the next \$432,513 of proceeds in the form of a dividend.

Equity Compensation Plan

The Company maintains the 2014 Incentive Plan (the "2014 Incentive Plan"), which was approved by shareholders in January 2014 and became effective April 12, 2014. Executives, eligible employees, consultants and non-employee directors are eligible to receive options and stock grants pursuant to the 2014 Incentive Plan. Pursuant to the 2014 Incentive Plan, options to purchase shares of stock and restricted stock awards can be granted with exercise prices, vesting conditions and other performance criteria determined by the Compensation Committee of the Board. The Company has reserved 1.6 million shares of common stock for issuance under the 2014 Incentive Plan. No awards have been made under the 2014 Incentive Plan. Prior to the effective date of the 2014 Incentive Plan, the Company granted stock awards to eligible participants under its 2004 Incentive Plan (the "2004 Equity Plan"), which expired April 11, 2014. No additional awards may be granted pursuant to the 2004 Equity Plan; however, awards outstanding as of April 11, 2014, will continue to vest and expire and may be exercised in accordance with the terms of the 2004 Equity Plan.

The Company estimates the fair value of share-based payment awards on the date of grant using the Black-Scholes option-pricing model ("Black-Scholes model"). Using the Black-Scholes model, the value of the portion of the award that is ultimately expected to vest is recognized as a period expense over the requisite service period in the

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statement of operations. Option forfeitures are to be estimated at the time of grant and revised if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company does not expect any forfeiture of its option grants and therefore the compensation expense has not been reduced for estimated forfeitures. During fiscal year 2012, 29,500 options were forfeited by option holders and an additional 48,000 options expired. No options were forfeited during the fiscal years ended August 31, 2013. During fiscal year 2014 65,000 options expired. The Company attributes the value of share-based compensation to expense using the straight-line single option method for all options granted.

The Company's determination of the estimated fair value of share-based payment awards on the date of grant is affected by the following variables and assumptions:

- The grant date exercise price – is the closing market price of the Company's common stock on the date of grant;
- Estimated option lives – based on historical experience with existing option holders;
- Estimated dividend rates – based on historical and anticipated dividends over the life of the option;
- Life of the option –based on historical experience option grants have lives between 8 and 10 years;
- Risk-free interest rates – with maturities that approximate the expected life of the options granted;
- Calculated stock price volatility – calculated over the expected life of the options granted, which is calculated based on the weekly closing price of the Company's common stock over a period equal to the expected life of the option; and
- Option exercise behaviors – based on actual and projected employee stock option exercises and forfeitures.

In January 2014, the Company granted its non-employee directors options to purchase a combined 32,500 shares of the Company's common stock pursuant to the 2004 Equity Plan. The options vest one year from the date of grant and expire ten years from the date of grant. The Company calculated the fair value of these options at \$132,900 using the Black-Scholes model with the following variables: weighted average exercise price of \$6.08 (which was the closing sales price of the Company's common stock on the date of the grant); estimated option lives of ten years; estimated dividend rate of 0%; weighted average risk-free interest rate of 1.84%; weighted average stock price volatility 63.6%; and an estimated forfeiture rate of 0%. The \$132,900 of stock-based compensation is being expensed monthly over the vesting periods.

In August 2013, the Company granted management options to purchase 100,000 shares of the Company's common stock pursuant to the 2004 Equity Plan. The options vest one-third one year from the date of grant, one-third two years from the date of grant, and one-third three years from date of grant. The options expire ten years from the date of grant. The Company calculated the fair value of these options at \$427,100 using the Black-Scholes model with the following variables: weighted average exercise price of \$5.88 (which was the closing sales price of the Company's common stock on the date of the grant); estimated option lives of ten years; estimated dividend rate of 0%; weighted average risk-free interest rate of 2.71%; weighted average stock price volatility 63.6%; and an estimated forfeiture rate of 0%. The \$427,100 of stock-based compensation is being expensed monthly over the vesting periods.

In January 2013, the Company granted its non-employee directors options to purchase a combined 32,500 shares of the Company's common stock pursuant to the 2004 Equity Plan. The options vest one year from the date of grant and expire ten years from the date of grant. The Company calculated the fair value of these options at \$76,800 using the Black-Scholes model with the following variables: weighted average exercise price of \$3.15 (which was the closing sales price of the Company's common stock on the date of the grant); estimated option lives of ten years; estimated dividend rate of 0%; weighted average risk-free interest rate of 1.84%; weighted average stock price volatility 69.2%; and an estimated forfeiture rate of 0%. The \$76,800 of stock-based compensation was expensed monthly over the one year vesting period.

In January 2012, the Company granted its non-employee directors options to purchase a combined 12,500 shares of the Company's common stock pursuant to the 2004 Equity Plan. The options vest one year from the date of grant and expire ten years from the date of grant. The Company calculated the fair value of these options at \$15,400 using

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the Black-Scholes model with the following variables: weighted average exercise price of \$1.85 (which was the closing sales price of the Company's common stock on the date of the grant); estimated option lives of ten years; estimated dividend rate of 0%; weighted average risk-free interest rate of 1.87%; weighted average stock price volatility 73.29%; and an estimated forfeiture rate of 0%. The \$15,400 of stock-based compensation was expensed monthly over the one year vesting period.

No options were exercised during the fiscal years ended August 31, 2014, 2013, or 2012.

The following table summarizes the stock option activity for the 2004 Equity Plan for the fiscal year ended August 31, 2014:

	Number of Options	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term	Approximate Aggregate Intrinsic Value
Ousting at beginning of period	347,500	\$ 5.62		
Granted	32,500	\$ 6.08		
Exercised	-	-		
Forfeited or expired	(65,000)	8.23		
Ousting at August 31, 2014	<u>315,000</u>	\$ 5.76	6.32	\$ 239,400
Options exercisable at August 31, 2014	<u>215,833</u>	\$ 6.47	4.59	\$ 10,792

The following table summarizes the activity and value of non-vested options as of and for the fiscal year ended August 31, 2014:

	Number of Options	Weighted- Average Grant Date Fair Value
Non-vested options outstanding at beginning of period	132,500	\$ 3.80
Granted	32,500	4.09
Vested	(65,833)	2.36
Forfeited	-	-
Non-vested options outstanding at August 31, 2014	<u>99,167</u>	\$ 4.85

All non-vested options are expected to vest. The total fair value of options vested during the fiscal years ended August 31, 2014, 2013 and 2012 was \$219,200, \$48,700 and \$66,000, respectively. The weighted average grant date fair value of options granted during the fiscal years ended August 31, 2014, 2013 and 2012 was \$4.09, \$3.80, and \$1.23, respectively.

Share-based compensation expense for the fiscal years ended August 31, 2013, 2012 and 2011, was \$251,900, \$66,800, and \$54,600, respectively.

At August 31, 2014, the Company had unrecognized expenses relating to non-vested options that are expected to vest totaling \$417,700. The weighted-average period over which these options are expected to vest is less than three years. The Company has not recorded any excess tax benefits to additional paid in capital.

Warrants

As of August 31, 2014, the Company had outstanding warrants to purchase 92 shares of common stock at an exercise price of \$1.80 per share. These warrants expire six months from the earlier of:

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- (i) The date all of the Export Water is sold or otherwise disposed of,
- (ii) The date the CAA is terminated with respect to the original holder of the warrant, or
- (iii) The date on which the Company makes the final payment pursuant to Section 2.1(r) of the CAA.

No warrants were exercised during fiscal 2014, 2013 or 2012.

Pledged Common Stock Owned by HP A&M

Pursuant to the Arkansas River Agreement, HP A&M pledged, transferred, assigned and granted to the Company a security interest in and to the Pledged Shares, consisting of 1,500,000 shares of Pure Cycle common stock and the proceeds there from. Due to the HP A&M default the Pledged Shares were sold pursuant to a foreclosure sale for \$3.5 million or \$2.35 per share during fiscal 2013.

NOTE 9 – SIGNIFICANT CUSTOMERS

The Company sells wholesale water and wastewater services to the District pursuant to the Rangeview Water Agreements. Sales to the District accounted for 9%, 34%, and 86% of the Company's total revenues for the years ended August 31, 2014, 2013 and 2012, respectively. The District had one significant customer, the Ridgeview Youth Services Center. Pursuant to the Rangeview Water Agreements the Company is providing water and wastewater services to this customer on behalf of the District. The District's significant customer accounted for 7%, 28%, and 53% of the Company's total revenues for the years ended August 31, 2014, 2013 and 2012, respectively.

Revenues from another customer directly and indirectly represented approximately 88% and 59% of the Company's water and wastewater revenues for the fiscal years ended August 31, 2014 and 2013. The Company had no revenues from this customer for the fiscal year ended August 31, 2012.

The Company had accounts receivable from the District which accounted for 5% and 14% of the Company's trade receivables balances at August 31, 2014 and 2013, respectively. Accounts receivable from the District's largest customer accounted for 4% and 12% of the Company's trade receivables as of August 31, 2014, and 2013, respectively.

NOTE 10 – INCOME TAXES

There is no provision for income taxes, because the Company has incurred operating losses. Deferred income taxes reflect the tax effects of net operating loss carryforwards and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets as of August 31 are as follows:

	For the Fiscal Years Ended August 31,	
	2014	2013
Deferred tax assets:		
Net operating loss carryforwards	\$ 7,279,900	\$ 6,080,000
Imputed interest on Tap Participation Fee	10,609,600	10,074,200
Deferred revenue	768,400	494,600
Impairment Charges	2,360,200	-
Depreciation and depletion	4,695,900	4,899,800
Other	26,700	43,600
Valuation allowance	(25,740,700)	(21,592,200)
Net deferred tax asset	\$ -	\$ -

The Company has not recorded a valuation allowance against the deferred tax assets as the Company is unable to reasonably determine if it is more likely than not that deferred tax assets will ultimately be realized.

Income taxes computed using the federal statutory income tax rate differs from our effective tax rate primarily due to the following for the fiscal years ended August 31:

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	For the Fiscal Years Ended August 31,		
	2014	2013	2012
Expected benefit from federal taxes at statutory rate of 34%	\$ (105,900)	\$ (1,411,200)	\$ (5,922,300)
State taxes, net of federal benefit	(10,300)	(137,000)	(574,800)
Expiration of net operating losses	89,400	147,400	90,000
Permanent and other differences	4,175,300	27,400	25,800
Change in valuation allowance	(4,148,500)	1,373,400	6,381,300
Total income tax expense / benefit	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

At August 31, 2014, the Company has \$19.5 million of net operating loss carryforwards available for income tax purposes, which expire between fiscal 2015 and 2029. Utilization of these net operating loss carryforwards may be subject to substantial annual ownership change limitations provided by the Internal Revenue Code. Such an annual limitation could result in the expiration of the net operating loss carryforwards before utilization.

Net operating loss carryforwards of \$239,600, \$395,200 and \$241,200 expired during the fiscal years ended August 31, 2014, 2013 and 2012, respectively.

NOTE 11 – 401(k) PLAN

The Company maintains a Pure Cycle Corporation 401(k) Profit Sharing Plan (the “Plan”), a defined contribution retirement plan for the benefit of its employees. The Plan is currently a salary deferral only plan, and at this time the Company does not match employee contributions. The Company pays the annual administrative fees of the Plan, and the Plan participants pay the investment fees. The Plan is open to all employees, age 21 or older, who have been employees of the Company for at least six months. During the fiscal years ended August 31, 2014, 2013 and 2012, the Company paid fees of \$3,600, \$3,300 and \$3,400, respectively, for the administration of the Plan.

NOTE 12 – LITIGATION LOSS CONTINGENCIES

The Company is involved in various claims, litigation and other legal proceedings that arise in the ordinary course of its business. The Company records an accrual for a loss contingency when its occurrence is probable and damages can be reasonably estimated based on the anticipated most likely outcome or the minimum amount within a range of possible outcomes. The Company makes such estimates based on information known about the claims and experience in contesting, litigating and settling similar claims. Disclosures are also provided for reasonably possible losses that could have a material effect on the Company's financial position, results of operations or cash flows.

The Company filed a lawsuit against HP A&M in the District Court, City and County of Denver, State of Colorado on April 4, 2014, alleging HP A&M breached the Arkansas River Agreement, Seller Pledge Agreement and Property Management Agreement, among other ways, by failing to (i) pay, perform and discharge its obligations when due or otherwise pursuant to the Excluded Indebtedness, (ii) cure defaults under the Notes and Deeds of Trust applicable to the Excluded Indebtedness, and (iii) use Net Revenue, pursuant to the Property Management Agreement, to pay Excluded Indebtedness. As a result of these breaches, the Company is claiming damages to be proven at trial, and estimated as of the date of the lawsuit to be not less than \$8 million. HP A&M filed its answer on May 30, 2014, asserting affirmative defenses and counterclaims, including, among others, breach of contract and breach of an implied covenant of good faith and fair dealing and requesting damages in an amount to be proven at trial. Because this lawsuit involves complex legal issues and uncertainties, the Company has determined that no accruals for losses related to the lawsuit are reasonably estimable or deemed reasonably likely as of August 31, 2014.

During the fiscal years ended August 31, 2014 and 2013, foreclosure proceedings were commenced against 38 of the properties acquired by the Company from HP A&M that are subject to promissory notes defaulted upon by HP A&M and secured by deeds of trust on the Company's land and water rights. The proceedings were filed on various dates from January 9, 2013 through March 12, 2014, with the Public Trustees of Bent, Otero and Prowers Counties in Colorado and involve claims against HP A&M for its failure to pay the notes. In addition one proceeding was commenced in 2013 and a second proceeding was commenced on May 5, 2014, pursuant to the Colorado Uniform Commercial Code (the “UCC”), in each case to foreclose on one FLCC certificate representing water rights only. As of the date of this filing, PCY Holdings, LLC (“PCY Holdings”), the Company's wholly owned subsidiary has been

See accompanying Notes to Financial Statements

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
August 31, 2014, 2013 and 2012

the successful bidder in foreclosure sales of 38 of the properties and water rights acquired by the Company from HP A&M (including two completed after the end of the fiscal year). The Company terminated one foreclosure proceeding by curing HP A&M's default. One of the Company's properties remains subject to foreclosure proceedings. This property represents less than 3% of the Company's FLLC shares and approximately 2% of the Company's Arkansas River land acquired from HP A&M.

Foreclosure sales that were conducted on three of the Company's farm properties on August 28, 2013, and on a fourth property on September 4, 2013 are currently the subject of litigation. PCY Holdings, was the successful bidder in the foreclosure sales. On September 16, 2013, HP A&M filed a complaint against PCY Holdings and the Public Trustee for the County of Bent, Colorado, in the District Court, County of Bent, Colorado seeking (i) a declaratory judgment that it is entitled to redeem the four properties from the foreclosure sales by paying the amount of the outstanding debt, plus fees, which is the amount PCY Holdings bid in the sales, and (ii) preliminary and permanent injunctions against the Public Trustee preventing the Public Trustee from issuing confirmation deeds for the foreclosure sales to PCY Holdings or anyone other than HP A&M. On November 20, 2013 the complaint was dismissed with prejudice, and judgment was entered in favor of the Public Trustee and PCY Holdings. Responses to motions filed by both PCY Holdings and HP A&M regarding attorney's fees awards have been stayed pending the outcome of the appeal discussed below.

On January 3, 2014 HP A&M filed a notice of appeal of the judgment with the Colorado Court of Appeals. If HP A&M wins on appeal, the Company could lose these four properties, subject to its remedies under the Arkansas River Agreement. The Company intends to vigorously defend any appeal of this ruling and to pursue the remedies against HP A&M for the defaults. Because the timing and outcome of the appeal is uncertain, the Company has determined that accruals for losses related to the appeal are not reasonably estimable or deemed reasonably likely at this time.

NOTE 13 – SEGMENT REPORTING

The Company operates primarily in two lines of business: (i) the wholesale water and wastewater business; and (ii) the agricultural farming business. The Company provides wholesale water and wastewater services to customers using water rights owned by the Company and develops infrastructure to divert, treat and distribute that water and collect, treat and reuse wastewater. The Company's agricultural business consists of the Company leasing its Arkansas River Valley land and water to area farmers under cash leases or in certain cases crop share leases. The following tables show information by operating segment for the fiscal years ended August 31, 2014 and 2013:

Fiscal Year Ended August 31, 2014

	Business segments			
	Wholesale water and wastewater	Agricultural	All Other	Total
Revenues	\$ 1,924,900	\$ 1,068,000	\$ 98,200	\$ 3,091,100
Gross profit	1,189,200	979,900	58,800	2,227,900
Depletion and depreciation	196,600	-	-	196,600
Other significant noncash items:				
Stock-based compensation	-	-	251,900	251,900
TPF interest expense	1,445,500	-	-	1,445,500
Impairment of land and water rights held for sale	402,700	-	-	402,700
Gain on extinguishment of contingent obligation	832,100	-	-	832,100
Gain on sale of land and water rights held for sale	1,308,600	-	-	1,308,600
Segment assets	98,851,900	7,354,100	1,967,800	108,173,800
Expenditures for segment assets	3,878,100	-	-	3,878,100

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
August 31, 2014, 2013 and 2012

Fiscal Year Ended August 31, 2013

	Business segments			
	Wholesale water and wastewater	Agricultural	All Other	Total
Revenues	\$ 544,400	\$ 1,241,900	\$ 71,200	\$ 1,857,500
Gross profit	248,600	1,145,600	70,000	1,464,200
Depletion and depreciation	311,300	-	-	311,300
Other significant noncash items:				
Stock-based compensation	-	-	66,800	66,800
TPF interest expense	3,275,400	-	-	3,275,400
Segment assets	93,522,800	6,697,500	8,398,000	108,618,300
Expenditures for segment assets	378,000	-	-	378,000

NOTE 14 – RELATED PARTY TRANSACTIONS

On December 16, 2009, the Company entered into a Participation Agreement with the District, whereby the Company agreed to provide funding to the District in connection with the District joining the South Metro Water Supply Authority (“SMWSA”). The Company provided funding of \$114,900, \$139,500, and \$115,500 for the fiscal years ended August 31, 2014, 2013, and 2012, respectively. The funding was expensed in the general and administrative expenses line in the accompanying statements of operations for the years ended August 31, 2014, 2013, and 2012, respectively. Through our funding agreement with the District and subsequent to fiscal year end, we made payments of \$535,200 to purchase certain rights to use existing water transmission and related infrastructure acquired by the WISE project. We anticipate will be investing approximately \$1.2 million per year for the next 5 years for additional payments for the water transmission line and additional facilities, water and related assets for the WISE project.

In 1995, the Company extended a loan to the District, a related party. The loan provided for borrowings of up to \$250,000, is unsecured, bears interest based on the prevailing prime rate plus 2% (5.25% at August 31, 2014) and matures on December 31, 2015. The \$568,000 balance of the note receivable at August 31, 2014 includes borrowings of \$229,300 and accrued interest of \$338,700. The \$556,000 balance of the note receivable at August 31, 2013 includes borrowings of \$229,300 and accrued interest of \$326,700. The Company extended the due date to December 31, 2015, and accordingly the note has been classified as non-current.

NOTE 15 – SUBSEQUENT EVENTS

Subsequent to our fiscal year end, an additional two farms and 981 FLCC shares have been obtained through the foreclosure proceedings, resulting in a reduction of the number of taps subject to the TPF by 1,801 taps and a corresponding reduction to the TPF payable of \$6.2 million.

Subsequent to the Company’s fiscal year-end, the Company borrowed \$4,450,000. Proceeds from the loan will be used to consolidate mortgage debt and for working capital. The note has a 20 year term, requires semi-annual payments, and carries a 5.27% per annum rate. The note is secured by a total of 3,596.8 acres, 3,282 FLCC shares, and an assignment of two HP A&M notes and deeds of trust with balances due of approximately \$843,400, which are secured by 1,087.4 FLCC shares.

Item 9 – Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

There were no changes in or disagreement with accountants on accounting and financial disclosures.

Item 9A – Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as such term is defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) that are designed to ensure that information required to be disclosed in our reports filed or submitted to the SEC under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Commission’s rules and forms, and that information is accumulated and communicated to management, including the principal executive and financial officer as appropriate, to allow timely decisions regarding required disclosures. The President and Chief Financial Officer evaluated the effectiveness of disclosure controls and procedures as of August 31, 2014, pursuant to Rule 13a-15(b) under the Exchange Act. Based on that evaluation, the President and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company’s disclosure controls and procedures were effective. A system of controls, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the system of controls are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

(b) Management’s Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) under the Exchange Act. The Exchange Act defines internal control over financial reporting as a process designed by, or under the supervision of, our executive and principal financial officers and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and our directors; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of August 31, 2014. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in Internal Control – Integrated Framework (“1992 COSO Framework”). Based on our assessment, we determined that, as of August 31, 2014, our internal control over financial reporting was effective based on those criteria.

(c) Report of the Independent Registered Public Accounting Firm.

The effectiveness of our internal control over financial reporting as of November 14, 2014 has been audited by GHP Horwath, P.C., an independent registered public accounting firm, as stated in its attestation report which is included in "Item 8. Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

(d) *Changes in Internal Controls*

No changes were made to our internal control over financial reporting during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

On May 14, 2013, COSO issued an updated version of its Internal Control - Integrated Framework (the “2013 COSO Framework”). Originally issued in 1992, the framework helps organizations design, implement and evaluate the effectiveness of internal control concepts and simplify their use and application. The 1992 COSO Framework remains available during the transition period, which extends to December 15, 2014, after which time COSO will consider it as superseded by the 2013 COSO Framework. As of August 31, 2014, we have initiated the process to transition to the 2013 COSO Framework.

Item 9B – Other Information

None

PART III

Information concerning Items 10 through Items 14 will be contained in, and is incorporated herein by reference to, our definitive Proxy Statement pursuant to Regulation 14A promulgated under the Exchange Act for the 2014 Annual Meeting of Shareholders, which is expected to be filed on or about December 5, 2014.

PART IV

Item 15 – Exhibits and Financial Statement Schedules

- (a) Financial Statements
1. See “Index to Financial Statements and Supplementary Data” in Part II, Item 8 of this Form 10-K.
 2. Financial Statement Schedules: None
 3. Exhibits: The exhibits listed in the accompanying “Index to Exhibits” are filed or incorporated by reference as part of this Form 10-K

Index to Exhibits

Exhibit No.	Description
3.1	Articles of Incorporation of Pure Cycle Corporation. Incorporated by reference to Appendix B to the Proxy Statement on Schedule 14A filed December 14, 2007.
3.2	Bylaws of Pure Cycle Corporation. Incorporated by reference to Appendix C to the Proxy Statement on Schedule 14A filed December 14, 2007.
4.1	Specimen Stock Certificate. Incorporated by reference to Exhibit 4.1 to Quarterly Report on Form 10-Q for the fiscal quarter ended May 31, 2010.
10.1	2004 Equity Incentive Plan, Incorporated by reference to Exhibit F to the Proxy Statement for the Annual Meeting held April 12, 2004. **
10.2	Wastewater Service Agreement, dated January 22, 1997, by and between Pure Cycle Corporation and the Rangeview Metropolitan District. Incorporated by reference to Exhibit 10.3 to the Annual Report on Form 10-KSB for the fiscal year ended August 31, 1998.
10.3	Comprehensive Amendment Agreement No. 1, dated April 11, 1996, by and among ISC, the Company, the Bondholders, Gregory M. Morey, Newell Augur, Jr., Bill Peterson, Stuart Sundlun, Alan C. Stormo, Beverlee A. Beardslee, Bradley Kent Beardslee, Robert Douglas Beardslee, Asra

- Corporation, International Properties, Inc., and the Land Board. Incorporated by reference to Exhibit 10.7 to the Quarterly Report on Form 10-QSB for the period ended May 31, 1996.
- 10.4 Agreement for Sale of Export Water dated April 11, 1996 by and among the Company and the District. Incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-QSB for the fiscal quarter ended May 31, 1996.
- 10.5 Water Service Agreement for the Sky Ranch PUD dated October 31, 2003 by and between Airpark Metropolitan District, Icon Investors I, LLC, the Company and the District. Incorporated by reference to Exhibit 10.9 to the Registration Statement on Form SB-2, filed April 19, 2004, Registration No. 333-114568.
- 10.6 Amendment to Water Service Agreement for the Sky Ranch PUD dated January 6, 2004. Incorporated by reference to Exhibit 10.13 to Amendment No. 1 to Registration Statement on Form SB-2, filed June 7, 2004, Registration No. 333-114568.
- 10.7 Agreement to Amend Water Service Agreement for the Sky Ranch PUD dated January 30, 2004. Incorporated by reference to Exhibit 10.14 to Amendment No. 1 to Registration Statement on Form SB-2, filed June 7, 2004, Registration No. 333-114568.
- 10.8 Second Amendment to Water Service Agreement for the Sky Ranch PUD dated March 5, 2004. Incorporated by reference to Exhibit 10.15 to the original Annual Report on Form 10-K for the fiscal year ended August 31, 2007.
- 10.9 Bargain and Sale Deed among the Land Board, the District and the Company dated April 11, 1996. Incorporated by reference to Exhibit 10.18 to Amendment No. 1 to Registration Statement on Form SB-2, filed June 7, 2004, Registration No. 333-114568.
- 10.10 Water Service Agreement for the Hills at Sky Ranch Water dated May 14, 2004 among Icon Land II, LLC, a Colorado limited liability company, the Company, and the District. Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on May 21, 2004.
- 10.11 Agreement for Water Service dated August 3, 2005 among Pure Cycle Corporation, Rangeview Metropolitan District and Arapahoe County incorporated by reference to Exhibit 10.24 to the Current Report on Form 8-K filed on August 4, 2005.
- 10.12 Arkansas River Agreement dated May 10, 2006, between Pure Cycle Corporation and High Plains A&M, LLC, and the Seller Pledge Agreement, Pure Cycle Corporation Pledge Agreement and Property Management Agreement, attached as exhibits thereto, entered into between Pure Cycle Corporation and High Plains A&M, LLC dated August 31, 2010. Incorporated by reference to Exhibit 10.25 to the Current Report on Form 8-K filed on May 16, 2006.
- 10.13 Amendment No. 1 to Agreement for Water Service dated August 25, 2008, between Pure Cycle Corporation and Arapahoe County. Incorporated by reference to Exhibit 10.36 to the Annual Report on Form 10-K for the fiscal year ended August 31, 2009.
- 10.14 Registration Rights Agreement dated September 28, 2010, between Pure Cycle Corporation and PAR Investment Partners, L.P. Incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed on September 29, 2010.
- 10.15 Paid-Up Oil and Gas Lease dated March 14, 2011, between Pure Cycle Corporation and Anadarko E&P Company, L.P. Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on March 15, 2011.
- 10.16 Surface Use and Damage Agreement dated March 14, 2011, between Pure Cycle Corporation and Anadarko E&P Company, L.P. Incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed on March 15, 2011.
- 10.17 2014 Incentive Plan, Incorporated by reference to Exhibit A to the Proxy Statement for the Annual Meeting held January 15, 2014. **

- 10.18 2014 Amended and Restated Lease Agreement, dated July 10, 2014, by and between the Land Board, the District, and the Company. Incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed on July 14, 2014.
- 10.19 2014 Amended and Restated Service Agreement, dated July 10, 2014, by and between the Company and the District. Incorporated by reference to Exhibit 10.5 to the Current Report on Form 8-K filed on July 14, 2014.
- 10.20 Settlement Agreement and Mutual Release, dated July 10, 2014, by and among the Land Board, the District, and the Company. Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on July 14, 2014.
- 10.21 Assignment and Termination Agreement, dated July 10, 2014, by and among the Land Board, the District, and the Company. Incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K filed on July 14, 2014.
- 10.22 Release of Mortgage and Termination Statement, dated July 10, 2014, by and between the Land Board and the Company. Incorporated by reference to Exhibit 10.4 to the Current Report on Form 8-K filed on July 14, 2014.
- 10.23 Settlement Agreement and Mutual Release, dated September 29, 2014, by and between HP and the Registrant. Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on September 30, 2014.
- 10.24 Business Loan Agreement dated October 27, 2014, between Pure Cycle Corporation and the First National Bank of Las Animas. Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on October 29, 2014.
- 10.25 Commercial Pledge Agreement, dated October 27, 2014, between Pure Cycle Corporation and the First National Bank of Las Animas. Incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed on October 29, 2014.
- 21.1 Subsidiaries
- 23.1 Consent of GHP Horwath, P.C. *
- 31.1 Certification under Section 302 of the Sarbanes-Oxley Act of 2002. *
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. *

* Filed herewith

** Indicates management contract or compensatory plan or arrangement in which directors or executive officers are eligible to participate.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PURE CYCLE CORPORATION

By: /s/ Mark W. Harding

Mark W. Harding, President and Chief Financial Officer

November 14, 2014

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Mark W. Harding</u> Mark W. Harding	President, Chief Financial Officer and Director (Principal Executive Officer, Principal Financial and Accounting Officer)	November 14, 2014
<u>/s/ Harrison H. Augur</u> Harrison H. Augur	Chairman, Director	November 14, 2014
<u>/s/ Arthur G. Epker III</u> Arthur G. Epker III	Director	November 14, 2014
<u>/s/ Richard L. Guido</u> Richard L. Guido	Director	November 14, 2014
<u>/s/ Peter C. Howell</u> Peter C. Howell	Director	November 14, 2014
<u>/s/ George M. Middlemas</u> George M. Middlemas	Director	November 14, 2014

EXHIBIT 21.1

SUBSIDIARIES

PCY Holdings, LLC, a Colorado limited liability company
PCY-DT, LLC, a Colorado limited liability company

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements on Form S-3 (No. 333-189166), Form S-8 (No. 333-115240), and Form S-8 (No. 333-195733) of Pure Cycle Corporation of our report dated November 14, 2014, related to the financial statements and internal control over financial reporting of Pure Cycle Corporation (which expresses an unqualified opinion), which appears on page F-1 of this annual report on Form 10-K for the year ended August 31, 2014.

/s/ GHP HORWATH, P.C.

Denver, Colorado
November 14, 2014

EXHIBIT 31.1

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Mark W. Harding, certify that:

1. I have reviewed this Annual Report on Form 10-K of Pure Cycle Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report my conclusion about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 14, 2014

/s/ Mark W. Harding

Mark W. Harding

Principal Executive Officer and Principal Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Mark W. Harding, the Chief Executive Officer and Chief Financial Officer of Pure Cycle Corporation (the “Company”), hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Form 10-K of the Company for the fiscal year ended August 31, 2014, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Mark W. Harding

Mark W. Harding
Principal Executive Officer and Principal Financial Officer
November 14, 2014

Proxy Statement
for the January 14, 2015
Annual Meeting of Shareholders



**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934

Filed by the Registrant
Filed by a party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material pursuant to Section 240.14a-12

PURE CYCLE CORPORATION

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

- (1) Title of each class of securities to which transaction applies:
- (2) Aggregate number of securities to which transaction applies:
- (3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
- (4) Proposed maximum aggregate value of transaction:
- (5) Total fee paid:

Fee paid previously with preliminary materials:

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

- (1) Amount Previously Paid: _____
- (2) Form, Schedule or Registration Statement No.: _____
- (3) Filing Party: _____
- (4) Date Filed: _____

PURE CYCLE CORPORATION
1490 Lafayette Street, Suite 203
Denver, CO 80218
(303) 292-3456

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
To be held on January 14, 2015

TO PURE CYCLE'S SHAREHOLDERS:

You are cordially invited to attend the annual meeting of shareholders' of Pure Cycle Corporation (the "Company"). The meeting will be held at 1550 Seventeenth Street, Suite 500, Denver, Colorado 80202, at the offices of Davis Graham & Stubbs LLP, on January 14, 2015 at 2:00 p.m. Mountain Time. The purposes of the meeting are to:

1. Elect a board of five directors to serve until the next annual meeting of shareholders, or until their successors have been duly elected and qualified;
2. Ratify the appointment of GHP Horwath, P.C. as the Company's independent registered public accounting firm for the 2015 fiscal year;
3. Approve, on an advisory basis, the compensation of the Company's named executive officer; and
4. Transact such other business as may properly come before the meeting or any adjournment(s) or postponement(s) thereof.

Only shareholders of record as of 5:00 p.m. Mountain Time on November 19, 2014 will be entitled to notice of or to vote at this meeting or any adjournment(s) or postponement(s) thereof.

Whether or not you plan to attend, please vote promptly by following the instructions on the Important Notice Regarding the Availability of Proxy Materials or, if you requested a printed set of proxy materials, by completing, signing and dating the enclosed proxy and returning it in the accompanying postage-paid envelope. Shareholders who attend the meeting may revoke their proxies and vote in person if they so desire.

BY ORDER OF THE BOARD OF DIRECTORS

/s/ Scott E. Lehman

Scott E. Lehman, Secretary

December 4, 2014

PURE CYCLE CORPORATION
1490 Lafayette Street, Suite 203
Denver, CO 80218
(303) 292-3456

PROXY STATEMENT FOR THE
ANNUAL MEETING OF SHAREHOLDERS
To be held on January 14, 2015

ABOUT THE MEETING

This proxy statement is being made available to shareholders in connection with the solicitation of proxies by the board of directors of PURE CYCLE CORPORATION (the "Company") for use at the annual meeting of shareholders of the Company (the "Meeting") to be held at 1550 Seventeenth Street, Suite 500, Denver, Colorado 80202, at the offices of Davis Graham & Stubbs LLP on January 14, 2015, at 2:00 p.m. Mountain Time or at any adjournment or postponement thereof. This proxy statement will be made available to shareholders on or about December 4, 2014. The cost of soliciting proxies is being paid by the Company. The Company's officers, directors, and other regular employees may, without additional compensation, solicit proxies personally or by other appropriate means.

How can I get access to the proxy materials?

Instructions on how to access the proxy materials, including this proxy statement and the Company's latest Annual Report on Form 10-K, on-line may be found in the Important Notice Regarding the Availability of Proxy Materials (the "Notice"), as well as instructions to request a printed set of such materials. You may also request the proxy materials by contacting the Company's transfer agent, Broadridge Corporate Issuer Solutions, by calling 1-800-579-1639, by writing the Company's Secretary at the Company's address set forth above, or by visiting www.proxyvote.com and entering the control number from the Notice.

If you would like to receive the Notice via email rather than regular mail in future years, please follow the instructions in the Notice. Choosing to receive future notices by email will help the Company reduce the costs and environmental impact of the Company's shareholder meetings.

What is the purpose of the Meeting?

At the Meeting, shareholders are asked to act upon the matters outlined above in the Notice of Annual Meeting of Shareholders and as described in this proxy statement. The matters to be considered are (i) the election of directors, (ii) the ratification of the appointment of the Company's independent registered public accounting firm for the fiscal year ending August 31, 2015, (iii) the approval, on an advisory basis, of the compensation of the Company's named executive officer, and (iv) such other matters as may properly come before the Meeting. Management will be available to respond to appropriate questions.

Who is entitled to vote and how many votes do I have?

If you were a shareholder of record as of 5:00 p.m. Mountain Time on November 19, 2014 (the "Record Date"), you will be entitled to vote at the Meeting or any adjournments or postponements thereof. On the Record Date, there were 24,037,598 shares of the Company's 1/3 of \$.01 par value common stock ("common stock") issued and outstanding. Each outstanding share of the Company's common stock will be entitled to one vote on each matter acted upon. There is no cumulative voting.

How do I vote?

If your shares are held in an account at a bank, brokerage firm, or other nominee in "street name," you need to submit voting instructions to your bank, brokerage firm, or other nominee in order to cast your vote. If you wish to vote in person at the Meeting, you must obtain a valid proxy from the nominee that holds your shares. If you are the shareholder of record, you may vote your shares by following the instructions in the Notice mailed on or about December 4, 2014, or, if you have received a printed set of the proxy materials, you may vote your shares by

completing, signing and dating the enclosed proxy card and then mailing it to the Company's transfer agent in the pre-addressed envelope provided. You may also vote your shares by calling the transfer agent at the number listed on the proxy card or by attending the Meeting in person.

Can I change or revoke my vote?

A proxy may be revoked by a shareholder any time before it is voted at the Meeting by submission of another proxy bearing a later date, by attending the Meeting and voting in person, or if you are a shareholder of record, by written notice of revocation to the Secretary of the Company.

Is my vote confidential?

Proxy instructions, ballots and voting tabulations that identify individual shareholders are handled in a manner that protects your voting privacy. Your vote will not be disclosed within the Company or to third parties, except: (1) as necessary to meet applicable legal requirements, (2) to allow for the tabulation of votes and certification of the vote, and (3) to facilitate a successful proxy solicitation. Occasionally shareholders provide written comments on their proxy cards, which are forwarded to management of the Company.

Will my shares held in street name be voted if I do not provide my proxy?

If you hold your shares through a bank, broker, or other nominee, your shares must be voted by the nominee. If you do not provide voting instructions, under the rules of the securities exchanges, the nominee's discretionary authority to vote your shares is limited to "routine" matters. Proposals 1 and 3 are not considered routine matters for this purpose, so if you do not provide your proxy, your shares will not be voted at the Meeting with respect to these proposals. In this case your shares will be treated as "broker non-votes" and will not be counted for purposes of determining the vote on these proposals.

A "broker non-vote" occurs when a nominee holding shares for a beneficial owner does not vote on a particular proposal because the nominee does not have discretionary voting power with respect to that item and has not received voting instructions from the beneficial owner.

What is a quorum?

The presence, in person or by proxy, of the holders of a majority of the outstanding shares of common stock constitutes a quorum at the Meeting for the election of directors and for the other proposals. Abstentions and broker non-votes are counted for the purposes of determining whether a quorum is present at the Meeting.

How many votes are required to approve the proposals?

- *Election of Directors* – The election of directors requires the affirmative vote of a plurality of the votes cast by shares represented in person or by proxy and entitled to vote for the election of directors. This means that the nominees receiving the most votes from those eligible to vote will be elected. You may vote "FOR" all of the nominees or your vote may be "WITHHELD" with respect to one or more of the nominees; however, a "withheld" vote or a broker non-vote (defined above) will have no effect on the outcome of the election.
- *Ratification of auditors, advisory vote on executive compensation, and other matters* – The number of votes cast in favor of the proposal at the Meeting must exceed the number of votes cast against the proposal for the approval of proposals 2, 3 and other matters. For proposals 2, 3 and any other business matters to be voted on, you may vote "FOR," "AGAINST," or you may "ABSTAIN." Abstentions and broker non-votes will not be counted as votes for or against a proposal and, therefore, have no effect on the vote. Because your vote on executive compensation is advisory, it will not be binding on the board of directors or the Company. However, the board of directors will review the voting results and take them into consideration when making future decisions regarding executive compensation.

If no specification is made, then the shares will be voted “FOR” the election as directors of the persons nominated by the board of directors, “FOR” proposal 2, “FOR” proposal 3, and otherwise, in accordance with the recommendations of the board of directors.

Does the Company expect there to be any additional matters presented at the Meeting?

Other than the items of business described in this proxy statement, the Company is not aware of any other business to be acted upon at the Meeting. If you grant a proxy, the persons named as proxy holders, Mark W. Harding and Harrison H. Augur, have the discretion to vote your shares on any additional matter properly presented for a vote at the Meeting. If for any unforeseen reason any of the director nominees are not available for election at the date of the Meeting, the named proxy holders will vote your shares for such other candidates as may be nominated by the board.

When will the results of the voting being announced?

The Company will announce preliminary results at the Meeting and will publish final results in a current report on Form 8-K to be filed within 4 days of the date of the Meeting.

VOTING SECURITIES AND PRINCIPAL HOLDERS THEREOF

The following table sets forth information as of November 19, 2014, as to the beneficial ownership of shares of the Company’s common stock by (i) each person (or group of affiliated persons) known to the Company to own beneficially 5% or more of the common stock, (ii) each director of the Company and each nominee for director, (iii) each executive officer and (iv) all directors and executive officers as a group. All information is based on information filed by such persons with the Securities and Exchange Commission (the “SEC”) and other information provided by such persons to the Company. Except as otherwise indicated, the Company believes that each of the beneficial owners listed has sole investment and voting power with respect to such shares. On November 19, 2014, there were 24,037,598 common shares outstanding. Shares not outstanding but deemed beneficially owned by virtue of the right of a person to acquire shares within 60 days of November 19, 2014, are included as outstanding and beneficially owned for that person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person.

Name and address of beneficial owner	Amount and nature of beneficial ownership	Percent of class
Mark W. Harding **	760,576 ¹	3.16%
Harrison H. Augur **	141,281 ²	*
Arthur G. Epker III - One International Place, Suite 2401, Boston, MA 02110	30,500 ³	*
Richard L. Guido **	33,000 ⁴	*
Peter C. Howell **	36,000 ⁵	*
George M. Middlemas - 225 W. Washington, #1500, Chicago, IL 60606	33,000 ⁶	*
<i>All officers and directors as a group (6 persons)</i>	1,034,357 ⁷	4.27%
PAR Capital Management, Inc. / PAR Investment Partners, L.P. / PAR Group, L.P. One International Place, Suite 2401, Boston, MA 02110	5,982,970 ⁸	24.89%
High Plains A&M, LLC - 301 St. Charles Ave., 3rd Floor, New Orleans, LA 70130	1,500,000 ⁹	6.24%
Trigran Investments, Inc. / Trigran Investments, L.P. 630 Dundee Road, Suite 230, Northbrook, IL 60062	1,615,127 ¹⁰	6.72%

* Less than 1%

** Address is the Company’s address: 1490 Lafayette Street, Suite 203, Denver, CO 80218

1. Includes 33,333 shares purchasable by Mr. Harding under options exercisable within 60 days. Includes 210,000 shares of common stock held by SMA Investments, LLLP, a limited liability limited partnership controlled by Mr. Harding.
2. Includes 33,000 shares purchasable by Mr. Augur under options exercisable within 60 days. Includes 10,000 shares of common stock held by Patience Partners, LLC, a limited liability company in which a foundation controlled by Mr. Augur is a 60% member and Mr. Augur is a 20% managing member. Includes 46,111 shares of common stock held in a margin account owned by Auginco, a Colorado partnership, which is owned 50% by Mr. Augur and 50% by his wife.
3. Includes 30,500 shares purchasable by Mr. Epker under options exercisable within 60 days. Excludes all shares of common stock held directly by PAR Investment Partners, L.P. (“PIP”). PAR Capital Management, Inc. (“PCM”), as the general partner of PAR Group, L.P. (“PGL”), which is the general partner of PIP, has investment discretion and voting control over shares held by PIP. No shareholder, director, officer or employee of PCM has beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Securities Exchange Act of 1934 (the “Exchange Act”)) of any shares held by PIP. Mr. Epker is an officer of PCM and has been a director of the Company since 2007. In his capacity as an officer of PCM, Mr. Epker has sole voting and dispositive power with respect to the shares of common stock held by PIP; however, Mr. Epker disclaims beneficial ownership of the shares held by PIP.
4. Includes 33,000 shares purchasable by Mr. Guido under options exercisable within 60 days.
5. Includes 35,500 shares purchasable by Mr. Howell under options exercisable within 60 days.
6. Includes 33,000 shares purchasable by Mr. Middlemas under options exercisable within 60 days.
7. Includes the following shares:
 - a. 210,000 shares held by SMA Investments, LLLP as described in number 1 above,
 - b. 198,333 shares purchasable by directors and officers under options exercisable within 60 days, and
 - c. 10,000 shares of common stock held by Patience Partners, LLC, and 46,111 shares of common stock held by Auginco, as described in number 2 above.
8. PIP owns directly 5,892,970 shares. PGL, through its control of PIP as general partner, has sole voting and dispositive power with respect to all 5,892,970 shares owned beneficially by PIP. PCM, through its control of PGL as general partner, has sole voting and dispositive power with respect to all 5,892,970 shares owned beneficially by PIP. Excludes 30,500 shares purchasable by Mr. Epker under options exercisable within 60 days. PIP, PGL and PCM disclaim beneficial ownership of such option shares.
9. This disclosure is based on a Schedule 13G filed by High Plains A&M, LLC (“HP A&M”) on September 11, 2006, and the Company’s knowledge that 1,500,000 shares previously held by HP A&M were sold by the Company in a foreclosure sale on September 27, 2012. By reason of the status of each of H. Hunter White, Mark D. Campbell and M. Walker Baus as a member and manager of HP A&M, each of them is deemed a beneficial owner of these shares. Each of them disclaims beneficial ownership of the shares held by HP A&M except to the extent of his pecuniary interest in the limited liability company.
10. This disclosure is based on a Schedule 13G/A filed by Trigran Investments, Inc. (“TII”), Trigran Investments, L.P. (“TIL”), Douglas Granat, Lawrence A. Oberman and Steven G. Simon on February 14, 2014. It includes 1,006,667 shares of common stock owned by TIL. By reason of its role as the general partner of TIL, TII may be considered the beneficial owner of the shares owned by TIL. By reason of their role as controlling shareholders and sole directors of TII, each of Douglas Granat, Lawrence A. Oberman and Steven G. Simon may be considered the beneficial owners of shares beneficially owned by TII.

DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth the Company's directors, director nominees, and executive officer and their positions currently held with the Company.

Name	Age	Position
Mark W. Harding	51	Director, President, CEO and CFO *
Harrison H. Augur	72	Chairman of the Board *
Arthur G. Epker, III	52	Director *
Richard L. Guido	70	Director *
Peter C. Howell	65	Director *

* Director nominee

The principal occupation and other information about each of the individuals listed above, including the period during which each has served as director or officer can be found beginning on page 16.

CORPORATE GOVERNANCE AND BOARD MATTERS

Board Leadership Structure

The Company's board of directors has chosen to separate the positions of Chief Executive Officer ("CEO") and Chairman of the board. Keeping these positions separate allows the Company's CEO to focus on developing and implementing the Company's business plans and supervising the Company's day-to-day operations and allows the Company's Chairman to lead the board of directors in its oversight and advisory roles. Because of the many responsibilities of the board of directors and the significant time and effort required by each of the Chairman and the CEO to perform their respective duties, the Company believes that having separate persons in these roles enhances the ability of each to discharge those duties effectively and, as a corollary, enhances the Company's prospects for success. The board of directors also believes that having separate positions provides a clear delineation of responsibilities for each position and fosters greater accountability of management.

Board Risk and Oversight

Our board of directors, as a whole and through its committees, has responsibility for the oversight of risk management. With the oversight of the Company's full board of directors, the Company's CEO is responsible for the day-to-day management of the material risks the Company faces. In its oversight role, the board of directors has the responsibility to satisfy itself that the risk management processes designed and implemented by management are adequate and functioning as designed. Annually, the board of directors holds strategic planning sessions with management to discuss strategies, key challenges, risks and opportunities for the Company. This involvement of the board of directors in setting the Company's business strategy is a key part of its oversight of risk management, its assessment of management's appetite for risk, and its determination of what constitutes an appropriate level of risk for the Company. Additionally, the board of directors regularly receives updates from management regarding certain risks the Company faces, including various operating risks. Management attends meetings of the board of directors and its committees on a regular basis, and as is otherwise needed, and are available to address any questions or concerns raised by the board on risk management and any other matters.

The Audit Committee is responsible for overseeing risk management of financial matters, financial reporting, the adequacy of the Company's risk-related internal controls, internal investigations, and enterprise risks, generally. The Nominating and Corporate Governance Committee (the "Nominating Committee") oversees the Company's corporate governance guidelines and governance-related risks, such as board independence, as well as management and director succession planning. The Compensation Committee oversees risks related to compensation policies and practices and is responsible for establishing and maintaining compensation policies and programs designed to create incentives consistent with the Company's business strategy that do not encourage excessive risk-taking.

Board Membership and Director Independence

Director Independence – At least a majority of the members of the board and all members of the board’s Audit, Compensation, and Nominating Committees must be independent in accordance with the listing standards of The NASDAQ Stock Market. The board has determined that five of the six current members, Messrs. Augur, Epker, Guido, Howell, and Middlemas, are independent pursuant to the standards of The NASDAQ Stock Market.

Terms of Directors and Officers – All directors are elected for one-year terms which expire at the annual meeting of shareholders or when their successors are duly elected and qualified. The Company’s officers are elected annually by the board of directors and hold office until their successors are duly elected and qualified.

Family Relationships of Directors and Officers – None of the current directors or officers, or nominees for director, is related to any other officer or director of the Company or to any nominee for director.

Board Meetings Held – The board of directors and each of the standing committees described below meet throughout the fiscal year on a set schedule. They also hold special meetings and act by written consent from time to time as appropriate. The Company’s independent directors meet regularly in executive sessions without management present. The executive sessions of independent directors are held in conjunction with each regularly scheduled board meeting.

During the fiscal year ended August 31, 2014, the board of directors held seven (7) meetings. All board members attended 75% or more of the aggregate of the total number of meetings of the board of directors and the total number of meetings held by all committees of the board on which the director served. All of the Company’s board members are expected to attend the annual meeting. All of the Company’s board members attended the 2014 Annual Meeting, except Mr. Guido.

Committees

The Board has three standing committees: Audit Committee, Compensation Committee and Nominating Committee. Each of the committees regularly reports on its activities and actions to the full board of directors.

Membership in the standing committees for 2014 is set forth below:

Fiscal 2014 Committee Membership			
Director	Audit Committee	Compensation Committee	Nominating Committee
M. Harding	—	—	—
H. Augur	X	X	X
A. Epker	—	X	X
R. Guido	X	—	Chair
P. Howell	Chair	—	—
G. Middlemas	—	Chair	—

Audit Committee – The Audit Committee consists of Mr. Howell (Chairman) and Messrs. Augur and Guido. The board of directors has determined that all of the members of the Audit Committee are “independent” within the meaning of the listing standards of The NASDAQ Stock Market and the SEC rules governing audit committees. In addition, the board has determined that Mr. Howell meets the SEC criteria of an “audit committee financial expert” by reason of his understanding of Accounting Principles Generally Accepted in the United States of America (“GAAP”) and the application of GAAP, his education, his experiences as an auditor and chief financial officer, and his understanding of financial statements. See Mr. Howell’s biography under *Election of Directors (Proposal No. 1)* for additional information.

The functions to be performed by the Audit Committee include the appointment, retention, compensation and oversight of the Company’s independent auditors, including pre-approval of all audit and non-audit services to be performed by such auditors. The Audit Committee Charter is available on the Company’s website at www.purecyclewater.com. The Audit Committee held seven (7) meetings during the fiscal year ended August 31, 2014.

Compensation Committee – The Compensation Committee consists of Mr. Middlemas (Chairman) and Messrs. Augur and Epker. The board of directors has determined that all members of the Compensation Committee are “independent” within the meaning of the listing standards of The NASDAQ Stock Market. The functions to be performed by the Compensation Committee include establishing the compensation of officers, evaluating the performance of officers and key employees, and administering employee incentive compensation plans. The Compensation Committee typically meets with the CEO to obtain information about employee performance and compensation recommendations. It also has the authority to engage outside advisors to assist the committee with its functions. The Compensation Committee has the power to delegate authority to the CEO or a subcommittee to make certain determinations with respect to compensation for employees who are not executive officers. The Company’s Compensation Committee Charter is available on the Company’s website at www.purecyclewater.com. The Compensation Committee held three (3) meetings during the fiscal year ended August 31, 2014.

Nominating and Corporate Governance Committee – The Nominating Committee consists of Messrs. Guido (Chairman), Epker and Augur. The board of directors has determined that all the members of the Nominating Committee are “independent” within the meaning of the listing standards of The NASDAQ Stock Market. The principal responsibilities of the Nominating Committee are to identify and nominate qualified individuals to serve as members of the board and to make recommendations to the board with respect to director compensation. In addition, the Nominating Committee is responsible for establishing the Company’s Corporate Governance Guidelines and evaluating the board and its processes. In selecting nominees for the board, the Nominating Committee is seeking a board with a variety of experience and expertise, and in selecting nominees it will consider business experience in the industry in which the Company operates, financial expertise, independence from the Company, experience with publicly traded companies, experience with relevant regulatory matters in which the Company is involved, and a reputation for integrity and professionalism. The Company does not have a formal policy with respect to the consideration of diversity in identifying director nominees, but it considers diversity as part of its overall assessment of the board’s functions and needs. Nominees must be at least 21 years of age and less than 75 on the date of the annual meeting, unless the Nominating Committee waives such requirements. Identification of prospective board members is done by a combination of methods, including word-of-mouth in industry circles, inquiries of outside professionals and recommendations made to the Company. The Nominating Committee Charter is available on the Company’s website at www.purecyclewater.com. The Nominating Committee held four (4) meetings during the fiscal year ended August 31, 2014.

The Nominating Committee will consider nominations for director made by shareholders of record entitled to vote. In order to make a nomination for election at the 2015 annual meeting, a shareholder must provide notice, along with supporting information (discussed below) regarding such nominee, to the Company’s Secretary by August 5, 2014, in accordance with the Company’s bylaws. The Nominating Committee evaluates nominees recommended by shareholders utilizing the same criteria it uses for other nominees.

Each shareholder recommendation should be accompanied by the following:

- The full name, address, and telephone number of the person making the recommendation, and a statement that the person making the recommendation is a shareholder of record (or, if the person is a beneficial owner of the Company’s shares but not a record holder, a statement from the record holder of the shares verifying the number of shares beneficially owned), and a statement as to whether the person making the recommendation has a good faith intention to continue to hold those shares through the date of the Company’s next annual meeting;
- The full name, address, and telephone number of the candidate being recommended, information regarding the candidate’s beneficial ownership of the Company’s equity securities, any business or personal relationship between the candidate and the person making the recommendation, and an explanation of the value or benefit the person making the recommendation believes the candidate would provide as a director;
- A statement signed by the candidate that he or she is aware of and consents to being recommended to the Nominating Committee and will provide such information as the Nominating Committee may request for its evaluation of candidates;
- A description of the candidate’s current principal occupation, business or professional experience, previous employment history, educational background, and any areas of particular expertise;

- Information about any business or personal relationships between the candidate and any of the Company's customers, suppliers, vendors, competitors, directors or officers, or other persons with any special interest regarding any transactions between the candidate and the Company; and
- Any information in addition to the above about the candidate that would be required to be included in the Company's proxy statement (including without limitation information about legal proceedings in which the candidate has been involved within the past ten years).

Compensation Committee Interlocks and Insider Participation – No interlocking relationship exists between any member of the board of directors or the Compensation Committee and any other company's board of directors or compensation committee.

Code of Business Conduct and Ethics

The Company has adopted a Code of Business Conduct and Ethics for its directors, officers and employees, which is available on the Company's website at www.purecyclewater.com.

Shareholder Communications with the Board

The board of directors has adopted a policy for shareholders to send communications to the board. The policy is available on the Company's website. Shareholders wishing to send communications to the board may contact the Chairman of the board at the Company's principal place of business or e-mail chairman@purecyclewater.com. All such communications shall be shared with the members of the board, or if applicable, a specified committee or director.

Director Compensation

Directors who are employees of the Company receive no fees for board service. Currently, Mr. Harding is the only director who is also an employee. Each non-employee director receives a payment of \$10,000 for each full year in which he or she serves as a director, with an additional payment of \$1,000 for each committee on which he or she serves, and \$1,000 for serving as chairman of the board. Directors receive \$500 for attendance at each board meeting and, if committee meetings are held separately from board meetings, each director receives \$500 for attendance at such committee meetings.

The following table sets forth summary information concerning the compensation paid to the Company's non-employee directors in fiscal 2014 for services to the Company:

Director Compensation			
Name	Fees Earned or Paid in		Total
	Cash	Option Awards (1)	
	(\$)	(\$)	(\$)
H. Augur (2)	20,500	26,600	47,100
A. Epker (3)	16,000	26,600	42,600
R. Guido (4)	17,500	26,600	44,100
P. Howell (5)	17,000	26,600	43,600
G. Middlemas (6)	14,000	26,600	40,600

- (1) In addition to cash compensation, pursuant to the Pure Cycle Corporation 2004 Incentive Plan, as amended (the "2004 Plan"), each non-employee director received an option to purchase 5,000 shares of common stock upon initial election or appointment to the board (which vested one-half on each of the first two anniversary dates of the grant) and an option to purchase 6,500 shares of common stock (2,500 shares prior to January 2013) at each subsequent annual meeting at which the non-employee director was re-elected to the board (which vested on the first anniversary of the date of the grant). The 2004 Plan was replaced by the 2014 Equity Incentive Plan (the "2014 Plan") effective as of April 12, 2014. Pursuant to the 2014 Plan, each non-employee director may receive an option to purchase shares of common stock at the discretion of the board, and the terms of such awards granted to non-employee directors, including the discretion to adopt one or more formulas for

the determination of non-employee director awards, are at the discretion of the board. The board has not yet adopted a formula for grants to non-employee directors under the 2014 Plan. The amounts in this column represent the aggregate grant date fair value of options granted during the Company's fiscal year ended August 31, 2014, as computed in accordance with FASB ASC Topic 718. For more information about how the Company values and accounts for share-based compensation see *Note 8 – Shareholders' Equity* to the Company's audited consolidated financial statements for the year ended August 31, 2014, which are included in the Company's 2014 Annual Report on Form 10-K.

- (2) The \$20,500 earned by Mr. Augur is comprised of: \$10,000 for serving on the board, \$1,000 for being chairman of the board, \$3,000 for serving on three committees, and \$6,500 for attendance at board and committee meetings (\$500 per meeting). Mr. Augur had 33,000 options outstanding as of August 31, 2014, all of which are exercisable within 60 days of the filing of this proxy statement.
- (3) The \$16,000 earned by Mr. Epker is comprised of: \$10,000 for serving on the board, \$2,000 for serving on two committees, and \$4,000 for attendance at board and committee meetings (\$500 per meeting). Mr. Epker had 30,500 options outstanding as of August 31, 2014, all of which are exercisable within 60 days of the filing of this proxy statement.
- (4) The \$17,500 earned by Mr. Guido is comprised of: \$10,000 for serving on the board, \$2,000 for serving on two committees, and \$5,500 for attendance at board and committee meetings (\$500 per meeting). Mr. Guido had 33,000 options outstanding as of August 31, 2014, all of which are exercisable within 60 days of the filing of this proxy statement.
- (5) The \$17,000 earned by Mr. Howell is comprised of: \$10,000 for serving on the board, \$1,000 for serving on one committee, and \$6,000 for attendance at board and committee meetings (\$500 per meeting). Mr. Howell had 35,500 options outstanding as of August 31, 2014, all of which are exercisable within 60 days of the filing of this proxy statement.
- (6) The \$14,000 earned by Mr. Middlemas is comprised of: \$10,000 for serving on the board, \$1,000 for serving on one committee, and \$3,000 for attendance at board and committee meetings (\$500 per meeting). Mr. Middlemas had 33,000 options outstanding as of August 31, 2014, all of which are exercisable within 60 days of the filing of this proxy statement.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

Persons Covered

This compensation discussion and analysis addresses compensation for fiscal 2014 for Mark W. Harding, the Company's President, CEO and Chief Financial Officer ("CFO") and its only executive officer.

Summary

The Company's compensation plan is designed to attract, retain and motivate quality executive talent critical to the Company's growth and success. The compensation plan is structured to reward the executive officer of the Company with competitive total pay opportunities through a compensation mix that emphasizes cash and non-cash incentives and merit-based salary increases, while de-emphasizing entitlements and perquisites.

In August 2013, in recognition of the many positive achievements in fiscal 2013, the Compensation Committee recommended and the board approved a cash bonus award and a stock option award for Mr. Harding and a salary increase for fiscal 2014 from \$262,500 to \$275,000. In August 2014, in recognition of significant achievements in fiscal 2014, the Compensation Committee recommended and the board approved a \$150,000 cash bonus award for Mr. Harding.

2014 Achievements

The Company's 2014 financial results improved compared to 2013, although it continues to operate at a loss in part due to the significant decline in new home construction in Colorado which started in 2006 and only recently has

begun to improve. Due in large part to the efforts and leadership of Mr. Harding, the Company achieved a number of financial and strategic objectives during fiscal 2014, including:

- A 274% increase in water revenues due to an increase in water sold for hydraulic fracturing (“fracking”);
- The acquisition of all but one of the defaulted promissory notes payable by HP A&M (the one having been purchased by HP A&M), the cure of one note purchased by an affiliate of HP A&M, and the completion of foreclosure proceedings on 31 properties and two certificates of the Fort Lyon Canal Company (“FLCC”) representing water rights only to clear title to the properties and obtain any mineral rights owned by HP A&M to recover amounts paid by the Company to resolve the HP A&M defaults;
- The generation of total gross revenue in excess of \$3 million;
- The expansion of water delivery and storage capacity by drilling three new water wells and developing a reservoir capable of storing 17 million gallons of water;
- The sale of approximately 1,874 acres of land along with 2,982 Fort Lyon Canal Company shares associated with this land for approximately \$5.8 million;
- The accomplishment of key elements of the WISE project (as defined below) including the following:;
 - In fiscal 2014, with funds provided by WISE participants, including the Company, the WISE project purchased a pipeline from the East Cherry Creek Valley Water and Sanitation District in which the Company, through the Rangeview Metropolitan District (the “District”), will own capacity;
 - Completion of the WISE pipeline purchase agreement, license agreement, and other key agreements for the WISE project; and
 - Securing financing of approximately \$1.4 million for a portion of the purchase of the Company’s share (as the District’s service provider) of the WISE project pipeline.

Through an agreement with the District, the Company has worked with regional water suppliers, including Denver Water and Aurora Water, to participate in a cooperative water project known as the Water Infrastructure Supply Efficiency partnership (“WISE”) to develop regional infrastructure and supplies.

Compensation Philosophy

The Company’s executive compensation program is administered by the Compensation Committee of the board of directors. The Compensation Committee is composed of Messrs. Middlemas, Augur and Epker, three independent, non-employee directors. The Compensation Committee reviews the performance and compensation level for the CEO and makes recommendations to the board of directors for final approval. The Compensation Committee also determines equity grants under the 2014 Plan, if any. The CEO may provide information to the Compensation Committee regarding his compensation; however, the Compensation Committee makes the final determination on the executive compensation recommendation to the board. Final compensation determinations are generally made in August at the end of the Company’s fiscal year. The following outlines the philosophy and objectives of the Company’s compensation plan.

The objectives of the Company’s compensation plan are to correlate executive compensation with the Company’s objectives and overall performance and to enable the Company to attract, retain and reward executive officers who contribute to its long-term growth and success. The compensation plan is designed to create a mutuality of interest between executive and shareholders through equity ownership programs and to focus the executive’s attention on overall corporate objectives, in addition to the executive’s personal objectives.

The goal of the Compensation Committee is to provide a compensation package that is competitive with compensation practices of companies with which the Company competes, provides variable compensation that is linked to achievement of the Company’s operational performance goals, and aligns the interests of the executive officer and employees with those of the shareholders of the Company. Additionally, the Compensation Committee’s

goal is to design a compensation package that falls within the mid-range of the packages provided to executives of similarly sized corporations in like industries.

Generally, the executive officer receives a base cash salary and an opportunity to earn a cash bonus based on attainment of predetermined objectives at the discretion of the Compensation Committee. Long-term equity incentives are also considered. The mixture of cash and non-cash compensation items is designed to provide the executive with a competitive total compensation package while not using an excessive amount of the Company's cash or overly diluting the equity positions of its shareholders. The Company's executive officer does not receive any perquisites or personal benefits. The executive officer is eligible for the same benefits available to all Company employees. Currently, this includes participation in a tax-qualified 401(k) plan, health and dental plans.

Compensation Consultants

The Compensation Committee charter authorizes the Compensation Committee to engage compensation consultants and other advisors to assist it with its duties. No compensation consultants were engaged by either management or the Compensation Committee.

Shareholder Feedback and Say-On-Pay Results

The Compensation Committee considers the outcome of shareholder advisory votes on executive compensation when making future decisions relating to the compensation of the CEO and the Company's executive compensation program. At the 2014 annual meeting of shareholders, 99% of the votes cast were for approval of the "say-on-pay" proposal. The Compensation Committee believes the results conveyed support for continuing with the philosophy, strategy and objectives of the Company's executive compensation program.

Compensation of the Company's CEO

The current compensation program for the Company's CEO consists of the following:

Base Salary – In August 2013, the Compensation Committee reviewed and recommended a salary for the CEO for the fiscal year ended August 31, 2014. Mr. Harding's base salary was established by the Compensation Committee based upon publicly available compensation data for executive officers in comparable companies in the water development industry, job responsibilities, level of experience, individual performance and contributions to the business throughout his career with the Company, and Mr. Harding's achievements in fiscal 2013.

In making the base salary decision, the Compensation Committee exercised its discretion and judgment based upon these factors. No specific formula was applied to determine the weight of each factor. While the Compensation Committee reviewed competitive compensation data, it did not benchmark Mr. Harding's compensation to that of any other company. In August 2013 the Compensation Committee recommended and the board of directors approved a salary increase to \$275,000 to be effective for fiscal 2014. In August 2014, the Compensation Committee recommended that Mr. Harding's salary remain at \$275,000 for fiscal 2015. The board approved the Compensation Committee's recommendation.

Incentive Bonus – The Compensation Committee's goal in granting incentive bonuses is to tie a portion of the CEO's compensation to the operating performance of the Company and to the CEO's individual contribution to the Company. The Compensation Committee did not benchmark the CEO's bonus to that of executive officers at other companies. In formulating recommendations for bonus compensation for Mr. Harding, the Compensation Committee considered a number of factors, including, among other things: (i) the extraordinary efforts put forth by Mr. Harding in negotiating the 2014 Amended and Restated Lease, dated July 14, 2014, among the Company, the District and the Colorado State Board of Land Commissioners (the "Land Board") and the resolution of the litigation with the Land Board, which led to HP A&M dismissing its 2012 lawsuit against the Company; (ii) Mr. Harding's efforts in handling the defaults by HP A&M on \$9.6 million of promissory notes secured by deeds of trust on the Company's Arkansas River land and water rights and the foreclosures and lawsuits associated with these defaults; (iii) the completion of nearly \$5 million in capital investments expanding the Company's water production and storage systems to serve additional demand for frack water; (iv) the progress made by Mr. Harding and the Company in achieving the objectives established by the Compensation Committee for fiscal 2014 (as discussed

below); (v) Mr. Harding's experience, talents and skills, and the importance thereof to the Company; and (vi) the potential availability of better paying positions for officers with Mr. Harding's experience and skills.

Development and operation of water and wastewater systems requires long-term planning to meet anticipated future needs of customers, balancing concerns of constructing expensive infrastructure in advance of customer demand with concerns of not being prepared for increased customer demands. Additionally, development of the areas to be served by the Company's water systems is a process that is anticipated to take many years and involves many factors which are not within the Company's control, including, but not limited to the decisions of the Land Board with respect to development of the Lowry Range; housing markets; and competing agendas of governmental entities, developers, environmental groups, conservation groups and agricultural interests. Therefore, performance plan objectives established by the Compensation Committee for the CEO and other key personnel tend to include long range objectives which cannot reasonably be expected to be completed in the course of a single year. Additionally, the Compensation Committee designs the plan to award performance without encouraging inappropriate risk taking.

In August 2013, the Compensation Committee recommended and the board of directors approved establishing a performance plan for fiscal 2014. The Compensation Committee structured the performance plan to provide for a maximum bonus payout for Mr. Harding equal to 100% of his salary if he achieved all of the performance objectives to the satisfaction of the board.

The 2014 performance plan was comprised of a number of financial and nonfinancial objectives, both short-term and long-term in nature, including the following objectives: (i) enter a water delivery agreement to sell fracking water; (ii) achieve gross revenues from the sale of fracking water of \$780,000; (iii) achieve total gross revenues of \$2.23 million; (iv) limit operating losses to \$660,000 (excluding litigation); (v) expand water delivery capabilities to targeted levels; (vi) negotiate with the Land Board to obtain certain corporate objectives, protect the Company's rights on the Lowry Range, and settle the Company's lawsuit against the Land Board; (vii) secure a development partner for Sky Ranch; (viii) repurchase remaining debt defaulted on by HP A&M; (ix) continue prosecution of foreclosure remedies against the properties subject to the HP A&M notes and deeds of trust; (x) complete a financing agreement for WISE; and (xi) negotiate a settlement of the outstanding litigation of HP A&M against the Company. The plan also included corporate strategic objectives the disclosure of which the Company believes would cause competitive harm. The Compensation Committee believed that the achievement of certain performance objectives, including the undisclosed targets, would be extraordinarily difficult and that it was unlikely that the CEO and key employees would be able to fully achieve them.

In August 2014, the Compensation Committee reviewed the Company's operating results for fiscal 2014 and evaluated the Company's success in achieving the performance plan objectives. The Compensation Committee determined that a bonus was warranted in recognition of Mr. Harding's success in achieving or making significant progress toward achieving the objectives established in the 2014 performance plan. The Compensation Committee recommended awarding, and the board authorized awarding, Mr. Harding a discretionary bonus of \$150,000 in fiscal 2014.

Long-Term Equity Incentives – The goal of long-term equity incentive compensation is to align the interests of the CEO with those of the Company's shareholders and to provide the CEO with a long-term incentive to manage the Company from the perspective of an owner with an equity stake in the business. It is the belief of the Compensation Committee that stock options and other equity based awards directly motivate an executive to maximize long-term shareholder value. The philosophy of the Compensation Committee in administering the Company's 2014 Plan is to tie the number of stock options and shares of stock awarded to each employee to the performance of the Company and to the individual contribution of each employee to the Company. The Compensation Committee did not recommend a stock option award for Mr. Harding during the fiscal year ended August 31, 2014. The Compensation Committee determined that it would be preferable to recognize Mr. Harding's achievements with a cash incentive since Mr. Harding currently owns a significant number of shares of common stock and holds options to purchase additional shares of common stock.

Discussion with Respect to Qualifying Compensation for Deductibility

Section 162(m) of the Internal Revenue Code imposes a limit on tax deductions for annual compensation (other than performance-based compensation) in excess of one million dollars paid by a corporation to its CEO and its other four most highly compensated executive officers. The Company has not established a policy with regard to Section

162(m) of the Internal Revenue Code, because the Company does not currently anticipate paying cash compensation in excess of one million dollars per annum to any employee. The Compensation Committee will continue to assess the impact of Section 162(m) on its compensation practices and determine what further action, if any, is appropriate.

Stock Ownership Requirements for Executive Officers

While the Company has not established stock ownership guidelines for its executive officer, at August 31, 2014, the Company's CEO owns stock with a market value of approximately of fourteen times his base salary, which is in excess of the five times base salary multiple that is the median multiple for the Top 100 of S&P 500 companies and excess of the six times base salary that the Institutional Shareholder Services ("ISS") defines as "robust" ownership, earning such companies the highest score on the item form ISS.

Executive Compensation Tables

The Company's CEO, Mr. Harding, is the Principal Executive Officer and the Principal Financial Officer of the Company and its only executive officer. Therefore, all tables contained in this section relate solely to Mr. Harding.

Summary Compensation Table

Summary Compensation Table					
Name and Principal Position	Fiscal Year	Base Salary (\$)	Bonus (\$)	Option Awards (1) (\$)	Total (\$)
Mark W. Harding	2014	275,000	150,000	—	425,000
President,	2013	262,500	80,000	427,099	769,599
CEO and CFO	2012	262,500	25,000	—	287,500

(1) The amount in this column represents the aggregate grant date fair value of stock options awarded in fiscal 2013 as computed in accordance with FASB ASC Top 718. See *Note 8 – Shareholders' Equity* to the Company's audited consolidated financial statements for the year ended August 31, 2014, which are included in our 2014 Annual Report on Form 10 K for a description of the assumptions used to value option awards and the manner in which the Company recognizes the related expense pursuant to FASB ASC Topic 718.

Grants of Plan Based Awards – Mr. Harding did not receive any option awards grants during the year ended August 31, 2014. Therefore, the Company has omitted the Grant of Plan Based Awards table.

Outstanding Equity Awards at Fiscal Year-End – The following table summarizes certain information regarding outstanding option awards held by the named executive officer at August 31, 2014. There are no other types of equity awards outstanding.

Outstanding Equity Awards at Fiscal Year-End				
Name	Number of Securities Underlying Unexercised Options (#) Exerciseable	Number of Securities Underlying Unexercise Options (#) Unexerciseable (1)	Option Exercise Price	Option Expiration Date
Mark W. Harding	33,333	66,667	\$5.88	8/14/2023

(1) One-third of the total number of shares of common stock subject to the option will vest on each of the first, second and third anniversary of the grant date, August 14, 2013.

Option Exercises and Stock Vested – Mr. Harding did not exercise any options or have any stock vest during the year ended August 31, 2014. Therefore, the Company has omitted the Option Exercise and Stock Vested table.

Pension Benefits – The Company does not offer pension benefits. Therefore, the Company has omitted the Pension Benefits Table.

Non-Qualified Deferred Compensation – The Company does not have any non-qualified deferred compensation plans. Therefore, the Company has omitted the Non-Qualified Deferred Compensation Table.

Termination or Change-in-Control Payments – The Company does not have any plan or arrangement that provides for payments to the executive officer in connection with a termination or change of control.

Compensation Committee Report¹

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis with management, and based on the Committee’s review and discussion with management, has recommended to the full board of directors that the Compensation Discussion and Analysis be included in the Company’s Proxy Statement for the Annual Meeting.

Respectfully submitted by the Compensation Committee of the Board of Directors

/s/ George M. Middlemas (Chairman)

/s/ Harry H. Augur

/s/ Arthur G. Epker, III

REPORT OF THE AUDIT COMMITTEE¹

The Audit Committee of the board of directors is comprised of independent directors and operates under a written charter adopted by the board of directors. The Audit Committee charter is reassessed and updated as needed in accordance with applicable rules of the SEC and The NASDAQ Stock Market.

The Audit Committee serves in an oversight capacity. Management is responsible for the Company’s internal controls over financial reporting. The independent auditors are responsible for performing an independent audit of the Company’s financial statements in accordance with the standards of the Public Company Accounting Oversight Board (“PCAOB”) and issuing a report thereon. The Audit Committee’s primary responsibility is to monitor and oversee these processes and to select and retain the Company’s independent auditors. In fulfilling its oversight responsibilities, the Audit Committee reviewed with management the Company’s audited financial statements and discussed not only the acceptability but also the quality of the accounting principles, the reasonableness of the significant judgments and estimates, critical accounting policies and the clarity of disclosures in the audited financial statements prior to issuance.

The Audit Committee reviewed and discussed the audited financial statements as of and for the year ended August 31, 2014 with the Company’s independent auditors, GHP Horwath, P.C. (“GHP”), and discussed not only the acceptability but also the quality of the accounting principles, the reasonableness of the significant judgments and estimates, critical accounting policies and the clarity of disclosures in the audited financial statements prior to issuance. The Audit Committee meets with GHP, with and without management present, to discuss the results of their examination and the overall quality of the Company’s financial reporting. The Audit Committee discussed and reviewed with GHP all communications required by generally accepted auditing standards, including those described in Statement on Auditing Standards (SAS) No. 61, as amended (AICPA, *Professional Standards*, Vol. 1. AU section 380), as adopted by the PCAOB in Rule 3200T. The Audit Committee has received the written disclosures and the letter from GHP required by the applicable requirements of the PCAOB regarding independent auditor communications with the Audit Committee concerning independence and has discussed GHP’s independence with GHP.

¹ These reports are not “soliciting material,” are not deemed “filed” with the Commission and are not to be incorporated by reference in any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, irrespective of any general incorporation language in any such filing, except to the extent the Company specifically references one of these reports.

Based on the foregoing, the Audit Committee recommended to the board of directors that the Company's audited financial statements be included in the Company's Form 10-K for the fiscal year ended August 31, 2014.

/s/ Peter C. Howell (Chairman)

/s/ Harrison H. Augur

/s/ Richard L. Guido

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Agreements with Related Parties

Arkansas River Transaction with HP A&M – The Company owns approximately 51,000 acre feet of water rights in the Arkansas River together with approximately 14,900 acres of farm land in southeastern Colorado. The Company acquired this water and land from HP A&M pursuant to an asset purchase agreement dated May 10, 2006 (the “Arkansas River Agreement”). As consideration for these assets, the Company issued HP A&M 3,000,000 shares of its common stock. As a result of this acquisition HP A&M owned more than 5% of the outstanding shares of common stock of the Company and became a related party. The Company also granted HP A&M the right to receive ten percent (10%) of gross proceeds, or the equivalent thereof, from the sale of the next 40,000 water taps (the “Tap Participation Fee” or “TPF”). The Tap Participation Fee is due and payable once the Company sells a water tap and receives the consideration due for such water tap. The TPF liability at August 31, 2014 was \$7.9 million, which represents the estimated discounted fair value of the Company's obligation to pay HP A&M 20% of the Company's gross proceeds, or the equivalent thereof, from the sale of the next 2,184 water taps sold by the Company.

Initially the obligation was to pay 10% of the Company's gross proceeds, or the equivalent thereof, from the sale of 40,000 water taps sold after the date of the Arkansas River Agreement. The 40,000 water taps were reduced to 2,184 water taps as a result of (i) sales of Arkansas River Valley land in 2006 and 2009, (ii) the sale of unutilized water rights owned by the Company in the Arkansas River Valley in 2007, (iii) the election made by HP A&M, effective September 1, 2011, pursuant to the Arkansas River Agreement, to increase the TPF percentage from 10% to 20%, and to take a corresponding 50% reduction in the number of taps subject to the TPF, (iv) the allocation of 26.9% of the Net Revenues (defined as all lease and related income received from the farms less employee expenses, direct expenses for managing the leases and a reasonable overhead allocation) received by HP A&M from management of the farm leasing operations from September 1, 2011 to August 3, 2012 prior to termination of the property management agreement entered into in conjunction with the Arkansas River Agreement, pursuant to which HP A&M agreed to manage the farm properties (the “Property Management Agreement”), and (v) the reduction of 17,243 taps as the result of foreclosures on certain farms pursuant to the remedies outlined in the Arkansas River Agreement, as described in more detail below.

60 of the 80 properties the Company acquired from HP A&M were subject to outstanding promissory notes payable to third parties. These promissory notes were secured by deeds of trust on the Company's Arkansas River properties and water rights. Commencing in the third quarter of fiscal year 2012 and since that date, HP A&M has defaulted on all of the notes and deeds of trust. As of September 1, 2012, HP A&M owed approximately \$9.6 million of principal and accrued interest on the notes. In fiscal 2013 and fiscal 2014, the Company acquired approximately \$7 million and \$2.6 million, respectively, of the promissory notes payable by HP A&M and cured one note purchased by an entity organized by the principals of HP A&M.

Although the Company is not legally responsible for paying the notes, if the Company did not remedy the defaults, it would lose over 75% of the Arkansas River properties and a comparable percentage of water rights. The Company has a right to collect from HP A&M the amounts the Company spends to remedy the defaulted notes. As a consequence of the defaults, the Company terminated the Property Management Agreement in August 2012 and, in September 2013, sold 1.5 million shares of Company common stock owned by HP A&M which were pledged by HP A&M to secure the payment and performance of the promissory notes, yielding approximately \$3.42 million of proceeds to the Company (net of fees).

During the 2014 fiscal year, 31 farms and two FLCC certificates representing water rights only went through foreclosure proceedings. In accordance with the Company's remedies pursuant the Arkansas River Agreement, the Company exercised its right to reduce the TPF as a result of these foreclosures. The Company reduced the number of taps subject to the TPF by 15,113 and the discounted present value of the TPF by approximately \$53.3 million.

Subsequent to the end of fiscal 2014, an additional two farms and 981 FLCC shares went through foreclosure proceedings resulting in a further reduction of taps subject to the TPF by 1,801 taps and the discounted present value of the TPF by approximately \$6.2 million, leaving 383 taps (approximately \$1.7 million) subject to the TPF.

On April 4, 2014, the Company filed a lawsuit against HP A&M in the District Court, City and County of Denver, State of Colorado, alleging HP A&M breached the Arkansas River Agreement, the Property Management Agreement, and related agreements. As a result of these breaches, the Company is claiming damages to be proven at trial, and estimated as of the date of the lawsuit to be not less than \$8 million.

Review and Approval of Related Party Transactions

It is the Company's policy as set forth in its Code of Business Conduct and Ethics that actual or apparent conflicts of interest are to be avoided if possible and must be disclosed to the board of directors. Pursuant to the Code of Business Conduct and Ethics, any transaction involving a related party must be reviewed and approved by the Audit Committee. Additionally, the Audit Committee Charter requires the Audit Committee to review any transaction involving the Company and a related party at least once a year or upon any significant change in the transaction or relationship. The Code also provides non-exclusive examples of conduct which would involve a potential conflict of interest and requires any material transaction involving a potential conflict of interest to be approved in advance by the board. If a waiver from the Code is granted to an executive officer or director, the nature of the waiver will be disclosed on the Company's website, in a press release, or on a current report on Form 8-K.

The Company annually requires each of its directors and executive officers to complete a directors' and officers' questionnaire that solicits information about related party transactions. The Company's board of directors and outside legal counsel review all transactions and relationships disclosed in the directors' and officers' questionnaire, and the board makes a formal determination regarding each director's independence. If a director is determined to no longer be independent, such director, if he or she serves on any of the Audit Committee, the Nominating Committee, or the Compensation Committee, will be removed from such committee prior to (or otherwise will not participate in) any future meeting of the committee. If the transaction presents a conflict of interest, the board of directors will determine the appropriate response.

ELECTION OF DIRECTORS (Proposal No. 1)

As of the time of the Meeting, the number of members of the board of directors will be fixed at five. The board of directors nominates the following persons currently serving on the board for reelection to the board: Mark W. Harding, Harrison H. Augur, Arthur G. Epker, III, Richard L. Guido, and Peter C. Howell.

Set forth below are the names of all nominees for director, all positions and offices with the Company held by each such person, the period during which each has served as such, and the principal occupations and employment of and public company directorships held by such persons during at least the last five years, as well as additional information regarding the skills, knowledge and experience with respect to each nominee which has led the board of directors to conclude that each such nominee should be elected or re-elected as a director of the Company.

Mark W. Harding. Mr. Harding joined the Company in April 1990 as Corporate Secretary and Chief Financial Officer. He was appointed President of the Company in April 2001, CEO in April 2005, and a member of the board of directors in February 2004. Mr. Harding brings a background in investment banking and public finance, having worked from 1988 to 1990 for Price Waterhouse's management consulting services where he assisted clients in public finance and other investment banking related services. In determining Mr. Harding's qualifications to be on the board of directors, the board of directors considered, among other things, that Mr. Harding is the President and a board member of the Rangeview Metropolitan District and serves on a number of advisory boards relating to water and wastewater issues in the Denver region, including a statewide roundtable created by the Colorado legislature charged with identifying ways in which Colorado can address the water shortages facing Front Range cities including Denver and Colorado Springs. Mr. Harding earned a B.S. Degree in Computer Science and a Masters in Business Administration in Finance from the University of Denver.

Harrison H. Augur. Mr. Augur joined the board and was elected Chairman in April 2001. For more than 20 years, Mr. Augur has been involved with investment management and venture capital investment groups. Mr. Augur has

been a managing member of Patience Partners, LLC since 1999. Mr. Augur received a Bachelor of Arts degree from Yale University, an LLB degree from Columbia University School of Law, and an LLM degree from New York University School of Law. In determining Mr. Augur's qualifications to serve on the board of directors, the board of directors has considered, among other things, his extensive experience and expertise in finance and law.

Arthur G. Epker, III. Mr. Epker was appointed to the board in August 2007. Since 1992, Mr. Epker has been a Vice President and partner of PAR Capital Management, Inc., an investment adviser. In that capacity, Mr. Epker manages a portion of the assets of PAR Investment Partners, L.P., a private investment fund. Mr. Epker is also a director of Champions Oncology, Inc. and The Steppingstone Foundation. Mr. Epker received his undergraduate degree in computer science and economics with highest distinction from the University of Michigan and received a Master of Business Administration from Harvard Business School. In determining Mr. Epker's qualifications to serve on the board of directors, the board of directors has considered, among other things, his extensive experience and expertise in finance and investment management.

Richard L. Guido. Mr. Guido served as a member of the Company's board from July 1996 through August 31, 2003, and rejoined the board in 2004. Mr. Guido was Associate General Counsel of DeltaCom, Inc., a telecommunications company, from March 2006 to March 2007. From 1980 through 2004, Mr. Guido was an employee of Inco Limited, a Canadian mining company (now known as Vale). While at Inco Mr. Guido served as Associate General Counsel of Inco Limited and served as President, Chief Legal Officer and Secretary of Inco United States, Inc., now known as Vale Americas, Inc. Mr. Guido received a Bachelor of Science degree from the United States Air Force Academy, a Master of Arts degree from Georgetown University, and a Juris Doctor degree from the Catholic University of America. In determining Mr. Guido's qualifications to serve on the board of directors, the board of directors has considered, among other things, his extensive experience and expertise in finance, law and natural resource development.

Peter C. Howell. Mr. Howell was appointed to fill a vacancy on the board in February 2005. From 1997 to present, Mr. Howell has served as an officer, director or advisor to various business enterprises in the area of acquisitions, marketing and financial reporting. From August 1994 to August 1997, Mr. Howell served as the Chairman and Chief Executive Officer of Signature Brands USA, Inc. (formerly known as Health-O-Meter), and from 1989 to 1994 Mr. Howell served as Chief Executive Officer and a director of Mr. Coffee, Inc. Mr. Howell is a member of the board of directors of Libbey, Inc., Global Lite Array Inc. (a subsidiary of Global-Tech Advanced Innovations Inc.) and Great Lakes Cheese, Inc., a privately held company. Mr. Howell received a Master of Arts degree in Economics from Cambridge University. In determining Mr. Howell's qualifications to serve on the board of directors, the board of directors has considered, among other things, his extensive experience and expertise in finance and financial reporting as well as his general business expertise.

The proxy cannot be voted for more than the five nominees named. Directors are elected for one-year terms or until the next annual meeting of the shareholders and until their successors are elected and qualified. All of the nominees have expressed their willingness to serve, but if because of circumstances not contemplated, one or more nominees is not available for election, the proxy holders named in the enclosed proxy card intend to vote for such other person or persons as the Nominating Committee may nominate.

THE BOARD OF DIRECTORS RECOMMENDS THAT THE SHAREHOLDERS VOTE "FOR" THE ELECTION AS DIRECTORS OF THE PERSONS NOMINATED.

**RATIFICATION OF APPOINTMENT OF INDEPENDENT
REGISTERED PUBLIC ACCOUNTING FIRM
(Proposal No. 2)**

Action is to be taken by the shareholders at the Meeting with respect to the ratification and approval of the selection by the Audit Committee of the Company's board of directors of GHP Horwath, P.C. ("GHP") to be the independent registered public accounting firm of the Company for the fiscal year ending August 31, 2015. In the event of a negative vote on such ratification, the Audit Committee of the board of directors will reconsider its selection. A representative of GHP is expected to be present at the Meeting. The GHP representative will have the opportunity to make a statement if he or she desires to do so, and is expected to be available to respond to appropriate questions.

The Audit Committee reviews and approves in advance the audit scope, the types of non-audit services, if any, and the estimated fees for each category for the coming year. For each category of proposed service, GHP is required to confirm that the provision of such services does not impair the auditors' independence. Before selecting GHP, the Audit Committee carefully considered that firm's qualifications as an independent registered public accounting firm for the Company. This included a review of its performance in prior years, as well as its reputation for integrity and competence in the fields of accounting and auditing. The Audit Committee has expressed its satisfaction with GHP in all of these respects. The Audit Committee's review included inquiry concerning any litigation involving GHP and any proceedings by the SEC against the firm.

GHP has no direct or indirect financial interest in the Company and does not have any connection with the Company in the capacity of promoter, underwriter, voting trustee, director, officer or employee. Neither the Company, nor any officer, director nor associate of the Company has any interest in GHP.

Fees – For the fiscal years ended August 31, 2014 and 2013, the Company was billed the following audit, audit-related, tax and other fees by its independent registered public accountant. The tax fees consist entirely of fees for the preparation of the federal and state corporate tax returns. All other fees consist of fees associated with the filing of the Company's S-8 in fiscal 2014 and S-3 in fiscal 2013. The Audit Committee approved 100% of these fees in accordance with the Audit Committee Charter.

	For the Fiscal Years Ended:	
	August 31, 2014	August 31, 2013
Audit Fees	\$ 59,225	\$ 62,000
Audit Related Fees	\$ —	\$ —
Tax	\$ 1,612	\$ 8,500
All Other Fees	\$ 1,585	\$ 3,640

Pre-Approval Policy – The Audit Committee has established a pre-approval policy in its charter. In accordance with the policy, the Audit Committee pre-approves all audit, non-audit and internal control related services provided by the independent auditors prior to the engagement of the independent auditors with respect to such services.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE “FOR” THE RATIFICATION OF THE APPOINTMENT OF THE INDEPENDENT AUDITORS.

**ADVISORY VOTE ON EXECUTIVE COMPENSATION
(Proposal No. 3)**

The following proposal provides our shareholders with the opportunity to vote to approve or not approve, on an advisory basis, the compensation of our named executive officer as disclosed in the proxy statement in accordance with the compensation disclosure rules of the SEC.

We urge shareholders to read the “Executive Compensation” section beginning on page 9 of this proxy statement, as well as the Summary Compensation Table and other related compensation tables and narrative, beginning on page 13 of the proxy statement, which provide detailed information on the compensation of our named executive officer. The Company's compensation programs are designed to support its business goals and promote short- and long-term profitable growth of the Company. Our 2014 Plan is intended to align compensation with the long-term interests of our shareholders.

We are asking shareholders to approve the following advisory resolution at the Meeting:

RESOLVED, that the shareholders of the Company approve, on an advisory basis, the compensation of the Company's named executive officer, as disclosed pursuant to Item 402 of Regulation S-K, including the disclosure under the heading “Executive Compensation” and in the compensation tables and accompanying narrative discussion in the Company's Definitive Proxy Statement.

This advisory resolution, commonly referred to as a “say-on-pay” resolution, is not binding on the Company or the board of directors. The say-on-pay proposal is not intended to address any specific item of compensation, but rather the overall compensation of our named executive officer and the executive compensation policies, practices, and plans described in this proxy statement. Although non-binding, the board of directors will carefully review and consider the voting results when making future decisions regarding the Company’s executive compensation program. Based on the advisory vote of the shareholders at the 2014 annual meeting of shareholders, the board of directors determined that it would conduct an advisory vote on executive compensation on an annual basis. Notwithstanding the foregoing, the board of directors may decide to conduct advisory votes on a more or less frequent basis and may vary its practice based on factors such as discussions with shareholders and the adoption of material changes to compensation programs.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE “FOR” THE APPROVAL, ON AN ADVISORY BASIS, OF THE COMPENSATION OF THE COMPANY’S NAMED EXECUTIVE OFFICER.

ACTION TO BE TAKEN UNDER THE PROXY

The proxy will be voted “FOR” the individuals nominated by the board and “FOR” approval of proposals 2 and 3, unless the proxy is marked in such a manner as to withhold authority to so vote. The proxy will also be voted in connection with the transaction of such other business as may properly come before the Meeting or any adjournments or postponements thereof. Management knows of no other matters, other than the matters set forth above, to be considered at the Meeting. If, however, any other matters properly come before the Meeting or any adjournment thereof, the persons named in the accompanying proxy will vote such proxy in accordance with their best judgment on any such matter. The persons named in the accompanying proxy will also, if in their judgment it is deemed to be advisable, vote to adjourn the Meeting from time to time.

OTHER INFORMATION

Section 16 (a) Beneficial Ownership Reporting Compliance

The Company’s directors and executive officers and persons who are beneficial owners of more than 10% of common stock are required to file reports of their holdings and transactions in common stock with the SEC and furnish the Company with such reports. Based solely upon the review of the copies of the Section 16(a) reports received by the Company and written representations from these persons, the Company believes that during the fiscal year ended August 31, 2014, all the directors, executive officers and 10% beneficial owners complied with the applicable Section 16(a) filing requirements, except Mr. Epker. Mr. Epker filed three late Form 4s reporting six transactions. There were no matching purchases and sales reported. The late reports related to shares held by Mr. Epker directly through an investment account over which Mr. Epker did not have investment discretion or control, which account has been closed.

Shareholder Proposals

Shareholder proposals for inclusion in the Proxy Statement for the 2016 annual meeting of shareholders must be received at the principal executive offices of the Company by August 5, 2015 but not before June 6, 2015. For more information refer to the Company’s Bylaws which were filed as Appendix C to the Proxy Statement on Schedule 14A filed with the SEC on December 14, 2007. The Company is not required to include proposals received outside of these dates in the proxy materials for the 2016 annual meeting of shareholders, and any such proposals shall be considered untimely. The persons named in the proxy will have discretionary authority to vote all proxies with respect to any untimely proposals.

Delivery of Materials to Shareholders with Shared Addresses

The Company utilizes a procedure approved by the SEC called “householding”, which reduces printing and postage costs. Shareholders who have the same address and last name will receive one copy of the Important Notice Regarding the Availability of Proxy Materials or one set of printed proxy materials unless one or more of these shareholders has provided contrary instructions.

If you wish to receive a separate copy of the proxy statement, the Notice, or the Company's Annual Report on Form 10-K, or if you are receiving multiple copies and would like to receive a single copy, please contact the Company's transfer agent at 1-855-418-5058, or write to or call the Company's Secretary at the Company's address or phone number set forth above, and the Company will undertake to deliver such documents promptly. If your shares are owned through a bank, broker or other nominee, you may request householding by contacting the nominee.

Form 10-K and Related Exhibits

The Company's Annual Report on Form 10-K is available, free of charge, at the Company's website, www.purecyclewater.com, or at the SEC's website, www.sec.gov. In addition, the Company will furnish a copy of its Form 10-K to any shareholder free of charge and a copy of any exhibit to the Form 10-K upon payment of the Company's reasonable expenses incurred in furnishing such exhibit(s). You may request a copy of the Form 10-K or any exhibit thereto by writing the Company's Secretary at: Pure Cycle Corporation, 1490 Lafayette Street, Suite 203, Denver, CO 80218, or by sending an email to info@purecyclewater.com. The information on the Company's website is not part of this proxy statement.

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This Annual Report to Shareholders, including the letter to the shareholders from President Mark W. Harding, contains forward-looking statements within the meaning of Section 27A of the Securities Exchange Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934 1934, as amended. The words “will”, “expect”, “should”, “scheduled”, “plan”, “believe”, “promise”, “anticipate”, “could” and similar expressions are intended to identify forward-looking statements. Pure Cycle expectations regarding these matters are only its forecasts. These forecasts may be substantially different from actual results, which are affected by many factors. The use of “Pure Cycle”, “our”, “we”, and similar terms are not intended to describe or imply particular corporate organizations or relationships.

Executive Officer and Directors

Mark W. Harding President, Chief Executive / Financial Officer, Director

Harrison H. Augur Chairman of the Board

Arthur G. Epker, III Director

Richard L. Guido Nominating and Governance Committee Chairman

Peter C. Howell Audit Committee Chairman

George M. Middlemas Compensation Committee Chairman

Corporate Legal Counsel

Davis, Graham & Stubbs LLP
1550 17th Street, Suite 500
Denver, CO 80202
303.892.9400

Independent Registered Public Accountants

GHP Horwath, P.C.
1670 Broadway, Suite 3000
Denver, CO 80202
303.831.5000

Stock Transfer Agent & Register

Broadridge Corporate Issuer Services, Inc.
1717 Arch Street, Suite 1300,
Philadelphia, PA 19103
855.418.5058



Our stock is traded on the NASDAQ Capital Market under the symbol “PCYO”.
For more information please visit our website at www.purecyclegwater.com

