

Participants

Mark Harding, President and CEO of Pure Cycle Corp ([PCYO](#))

Nate Abercrombie, [The Stock Podcast](#)

Interview Transcript

Nate: Thank you Mark for coming onto the IwtB Podcast. It's going to be a pleasure talking about your business. Thank you very much for agreeing to an interview.

Mark: Well I appreciate the opportunity Nate.

Nate: So could you first start out just talking about your background.

Mark: Sure. I came through this side of the business on really investment banking. I had an undergraduate degree in Computer Engineering back in the mid-80s, went to work for an engineering consulting firm, worked on a fascinating project. It was on contract to the USGS and we were working on the high level radioactive waste repository license. So this is where the federal government is looking at putting the power plant fuel rods in a safe storage keeping vessel. And at the time I was looking at this project we were looking at five different sites. My particular site or my team's site and I was just one of many number of team members and the site was the Yucca Mountain site in Nevada which is ultimately the site that got picked for the most suitable place to put this. But I think it's still stuck even 30 years later in a regulatory bureaucracy of trying to get that thing permitted such that they can do something with that. But learned relatively quickly that there were many other smarter people than I was on the very technical side of computing. And then we were looking at hydrology and so it was a lot of water analytics and how water moves, where it moves and the pace at which it moves.

Mark: Went back to business school. Got my graduate degree in finance and then from there went to work for PriceWaterhouse which was back when the accounting firms were all things to all people they had a consulting practice and so I was part of that consulting practice and was working in their investment banking practice. And so the particular specialty most of the public finance needs that municipalities face are going to be relative to water and sewer because they're very capital intensive so you have to have a lot of financing to be able to build the facilities that you need to build on water and sewer facilities. So we were doing a lot of work with clients which happened to also be audit or tax clients of the firm providing them some investment banking related services and then the Pure Cycle was an audit engagement for the firm. So the audit partner came down and asked me to take a look at what they were doing, met with the managing team at the time and kind of gave them my recommendations of what I thought they should be focusing on and they said "You're right, we should be focusing on that, you need to come help us do that." And so that was about 29 years ago. Yeah.

Nate: So how did you come across ... So I've heard the story from a couple of different people, the story about you actually acquiring the water rights that eventually became Pure Cycle. Could you walk us through how that transpired?

- Mark: You bet. So originally the company focused on manufacturing what I'll call widgets which was they were building a single family standalone water recycling system for a single-family house. And what you do is you'd put the system behind your house and you'd have a clean water tank on one end, a dirty water tank on the other end and a process, a system in between those two that would process that water. So all day long you would use the clean water through the household and all the plumbing would go into the dirty water tank and then all night it would process that water back into clean water so that you'd wake up in the morning and you'd have your fresh supply of water. And so my recommendation was while the technology was great and there's a lot of different ways that you can take dirty water and turn it into clean water, that's not special what their particular niche was that they had sort of a process that allowed them to do that on a smaller scale. And they said you know you're attacking this at a very difficult scale where you're doing it on an individual unit basis and you need to be doing this more on a large municipal wide basis. And really the most valuable component of that is not what you're making, it's the resource itself.
- Mark: And so you know I'm a Denver native growing up in Colorado. It was difficult to grow up here and not be aware of the sensitivities and the value of water resources just because we have such a limited amount of supply here. And so my recommendation was you need to go long on water and coming out of business school it sort of had a good fit because it had a real analytic to it. When you have a fixed supply of something, whatever that something is and a growing demand and you can't change the supply and you're going to have growing demand, your macro-economics class tells you that's where you want to be. You want to own that supply because you just can't create it. And it's interesting you know if you look at this thing on a macro scale it's one of the few businesses or the few commodities that you're going to be doing the same thing with water a hundred years from now that you're going to do today. It's not something that's going to be obsoleted, it's not something that's going to be perishable or technology is going to inundate or anything like that. Water has that critical long sustaining value. So looking at it from that perspective that was my advice, buy all the water you can.
- Mark: And so when I came into the company we did just that and probably even bought more than we can afford through the years but was really looking at owning that, holding it, it's very cost prohibitive to buy. So there's a high barrier to entry to acquire water rights, it's very costly to get that on the front end. It's very cheap to hold but it's very costly to get into the game. And then that continued to grow in value. So we went out and we were scouring the number of different projects and I remember taking a look at the project that is our principal asset, the project with the Loughery supply.
- Mark: And at the time you know we were going to take a position on that and almost everybody in the market said "Boy you know you're crazy, they're not going to need that asset for 25 years." And they were right. I mean at the end of the day there was a little bit of dead time in there where we were a bit early in that cycle to acquire that supply. But if we had to wait till today to do something there could be no way we could afford it. I mean it was fortuitous for us to have that position, be able to hold that position, to be able to own that with a perpetual currency or the equity currency of a public company and then really capitalize on opportunities to monetize that.
- Mark: So that was really our venture is to come in early, get that supply and then continue to build on that supply with infrastructure and that infrastructure can be built and financed when you have customers for that. So that's kind of how we've acquired this through the years and then we've had other bolt on acquisitions to that supply where we were able to add elements of that either infrastructure or other water rights that are companion water rights to the supply through the years.

- Nate: So when did you buy the Loughery water rights?
- Mark: So our first money into that probably was back in maybe 1988 '89 timeframe. So this is a very very long time ago, 30 years ago.
- Nate: Yeah. And how do you buy water rights? Is there like an auction every year? How does it work?
- Mark: It's interesting. I remember talking about this to Wall Street and to money managers through the years. And it was a foreign concept that you could actually own water. I mean in Colorado and I would say Colorado is probably the tip of the spear on defining ownership of water as a property interest. And so we have very special protections for water here, we have very special constitutional protections that allow owners of that privileges, that it's difficult to be able to use eminent domain rights to have somebody condemn a water right just because they think they have a higher or better use for it. That's just not done. And so it's much like real estate. You can buy water with ground, you can buy ground without water, you can buy water without ground or as a combination. So any number of those where you can do it as a asset transaction just like real estate. You can get separate title on water. So you can get an insurable title policy as it relates to the acquisition. That's how defined ownership of water is in the state of Colorado. And predominantly under sort of the Western water laws, what I would define as appropriation system, that's very common that you can have a severable property interest in owning water.
- Nate: So where do you acquire, where do you buy them? [crosstalk 00:08:52]
- Mark: From a property owner, a farmer that would say "Hey listen, third generation, my kids don't want to farm anymore. The value of my dirt might be a few hundred dollars but the value of my water is several thousands of dollars. And so the water could be worth ten times what the dirt's worth."
- Nate: The Loughery water rights, was it the city or the Air Force or something that-?
- Mark: No that particular asset was actually a joint venture with the state of Colorado. So the state of Colorado has a constitutionally empowered entity called The Colorado State Land Board and federal government when the state became a state gave western states land trusts. So they were able to give Colorado every Section 16 and Section 36 in every township in range throughout the state of Colorado lands that they could manage for public schools. And so what they've done over the 130 years of the state's existence is they take those assets and then they partner with private enterprise to develop the assets for a royalty and then that royalty then goes into fund public education. So what we do creates a royalty to K through 12 public schools, that's the largest, they have a number of beneficiaries but that's the largest beneficiary in the state of Colorado.
- Mark: Originally when the federal government gave them they had something like 4 million acres of land. So kind of dependent. Certain states got two sections of ground, some states got four sections of ground and they really managed that together with their private partnerships to be able to develop those. Whether that's oil and gas, whether that's land development, any number of water, timber, coal, any sort of resource development that they would be able to generate revenue for public education.
- Nate: You mentioned Colorado being kind of the tip of the spear for water rights and just defining them and I remember it was the first drought that I experienced after moving here that had these rules that came down in terms of how much we can water our yard and then I had this neighbor across the street who's like fourth

generation Denverite. And he said "I don't give a shit about the rules that the city passes down because I don't think that California deserves to have this many flowing cubic meters per second or whatever it is-

Mark: Cubic feet per second.

Nate: Yeah. And I looked into it and I was shocked at how defined the rules are in terms of what the obligation is for Colorado to deliver water to Utah, to Arizona, to California, to Mexico. And these rules, these laws are like 100 years old, 150 years old.

Mark: Yup yup. So I'll give you an interesting statistic. There's two states that are net exporters of water which means no water flows into the state, water only flows out of the state. Can you guess what the other state is? So because I mentioned it, Colorado is one of them. But the other state ironically is Hawaii.

Nate: Really? I would've never guessed that.

Mark: Yeah yeah, I mean because you would think nothing's really flowing into it. It's just the precipitation and really that's why Colorado is so focal in water matters, is we are the headwaters for five major tributary water supplies that flow out of the state and that's due to our elevation. Right we're high in the scheme of the thrust of the tectonic plates on this thing and so when we get precipitation here it all flows out of the state. And so yes you're right we have very complicated what we call compacts and whether that's flowing east to Kansas or Nebraska or whether that's flowing west through the Colorado River into Utah or New Mexico. Very complex. We can't just stop water availability because there's historic flows and there's compacts and treaties with Mexico that allow the use of water flows, historic water flow. So it's a very sophisticated system of how you manage and how you protect those rights and that's why we have so many water lawyers. We have a separate bar here in Colorado where you have a whole separate court system that deals with nothing but water administrative-

Nate: Really? I did not realize that. But you say it's sophisticated. These rules were determined so long ago with global warming and the weather patterns changing that's definitely going to change the amount of snow pack and ultimately flows downstream. So has it changed much over the hundred past however many years?

Mark: It is cyclical. And I will say that you do have changing weather patterns that do have a large degree of variability on how much precipitation we get. Colorado it's a marvelous state. Right. Mother Nature does us a terrific service. And typically all of our precipitation here comes in the form of snow pack. So when we talk about what our weather patterns is or what our precipitation is we can say okay we usually get around 13 inches of precipitation a year but that that precipitation comes in that form of snow pack. So Mother Nature spends six months of the year storing all of that precipitation for us which is terrific right. We get to a hold that for a period of time but it has a sense of humor has a sense of humor. Because when we get it, we get it in 45 day. I mean it all comes on the spring snow melt, it comes and it rushes through the system in all of our spring runoff and that happens to be about 30 days in advance of our demand cycle of when we want to start our irrigation and when our summer season goes.

Mark: And so we have a very cyclical cycle of how water comes to us as well as of the demand side. So our summertime use here in the state of Colorado is three times what our wintertime use is because we just don't irrigate year round. In California they irrigate year round, in other parts of the country they can irrigate year round. We only irrigate four months in the summer and we have these huge peak water demands. And

so if you're not able to catch that water when it's coming down in the system it's gone forever, it's gone for that year. So not only is supply an important component of that but what you do with it, how you store it, the buckets that you can put that in and be able to catch it when it's available and use it when you need it.

Mark: So back to your original question. Climate change is an important component of that and it changes the variability and seasonality of the issues and that's something that we pay a lot of attention to is to make sure that we have storage that can carry us over in multi-year drought cycles where you might have low precipitation two, three years in a row and your demand wants to be at that same level. And then we have to restrict our users. We have to come in and say "Hey listen we're going to have watering restrictions, we're going to have a certain day of the week that you can water your lawns or certain times of the day where we can water those lawns to help regulate that supply variability."

Nate: Yeah yeah. No it's a fascinating topic and one that I'm learning about every year now that I'm in Colorado. So what does Pure Cycle do? Let's get back to the business. So what exactly does Pure Cycle do?

Mark: So at a DNA level we're a water utility company. We are what you would normally think of when you think of paying your water bill to your XYZ water provider. Typically that service is provided by a municipal government. If you look at nationwide about 15 percent of water utilities are provided by private water utilities. And we are one of those private water utilities. We happen to operate in the state of Colorado but for the most part it is a water utility that develops water supply for consumers and we go cradle to grave in that. We buy the water rights where we own the real property interest, we develop the infrastructure that diverts it, that treats it, that distributes it to our customers. We collect it back once they turn it into a liability. We process that, we clean that back up and then we reuse that water supply because here in a landlocked state the most valuable supply, new water supply, is going to be your wastewater supply and being able to turn that back into clean water. We don't have that in a closed loop system, we have two systems that deliver water to customers. We have our domestic system that takes it to the house and then we have irrigation system which takes highly treated wastewater and puts that out for parks and open space and common areas to irrigate the outdoor lawns.

Nate: Is that greywater? Is that what you call greywater?

Mark: Couple of different, greywater or blackwater, sewer wastewater as well as just raw water or wastewater. So greywater is typically what you would say washing machines, non-sewer water that's just dirty water. But all that stuff gets blinded in the same system.

Nate: I see. So are you regulated by the state?

Mark: So the state does have some regulatory oversight in the industry. We typically view this as an open market as it relates to the exchange of the water commodity itself, the real property interests. So we don't regulate that at all because that's a property interest. And the state has a mechanism for how water is delivered to a community. So Colorado is a very sensitive tax state. So we define this as a sales tax incentive state where a large disproportionate amount of government income comes from sales tax. We have very modest property taxes here. We have very modest income tax. So you still have to get the same level of money to operate your governmental services and if we're going to have modest revenue sources on those first two then you've got to have a weighted mechanism on sales tax. And so because we protect those mill levies we'll call it,

those are your property taxes, so aggressively, it's very difficult for cities and municipalities to go to their constituents every time they want to use any mill levies have to approve that.

Mark: And you might imagine that a city or municipality would go to their voter constituency and say "Hey listen, I want to build the next subdivision, the next community and I need some mills from you to be able to go out and acquire the water supplies to be able to do that." That's not no, that's just heck no. We'll never allow you to do that because they just don't benefit from that. And so we have a fee mechanism that allows that to happen. So instead of doing that through taxes, we do that through something called tap fees or connection charges. Water utilities end up collecting these large upfront one time capital payments to help cover the cost of acquiring the water supplies. We call that the tap business or the system development charges. And those are sort of loosely regulated at all because you have choice. Any developer can either choose to get their water supply from us or some other source or develop it themselves. There's nothing that would prevent them from developing their own water supply.

Mark: And in Denver if you take a look at the metropolitan area of Denver say the four and a half million people that make up the greater metropolitan area, there's probably as many as 70 different water providers that make up the Denver metropolitan area. So very fractionated market segment because it's been an open market. Once you get a customer then it's a little more pragmatic. You cannot be userith with your rates. You don't have to necessarily go to a PUC to get a rate increase but you do have to maintain a cost of service type approach once you've got that connection because they can't go get that water supply from somebody else. But those connection charges are amortized really in the cost of a house. So typically a home builder, the developer, is going to pay those tap fees and then when you buy your home that is an incorporated cost in the cost of your house.

Nate: So how do you determine what the connection fees are?

Mark: So we want to be competitive. Right. We're out soliciting expansion of our service areas and so we look at the surrounding water providers, we look at where our cost basis is and we come to a cumulative number for a tap fee that says hey this is a competitive fee compared to other options that a developer or a homebuilder might have. And then when we have the rate per thousand gallons then that's also a very comparable fee when you look at OK what's our water rate compared to if that user were getting water from another service provider. And are those in a relative proximity because everybody looks at that, that's to say it costs us all about the same amount to deliver the service. There are certain efficiencies that one may bring versus another and then we set our rates based on that cumulative average.

Nate: I see. Okay. And could you talk about your infrastructure today? So who are your customers? And then I'm very curious about the wastewater treatment part too, whether or not do you have existing infrastructure and-?

Mark: Sure. So we monitor sort of our capacities based on what our portfolio can serve. So we have something like 27000 acre feet of water and an acre foot of water is literally one acre one foot deep. And if you transfer that into more tangible that's really exactly 325,800 gallons of water. So you take a look at that and that typically is enough water in Denver given our irrigation cycle, the four month seasonality of outdoor irrigation, that's typically enough water to serve two single family homes, maybe two and a half single family homes for a year.

Nate: One acre foot?

Mark: One acre foot.

Nate: Okay.

Mark: That trend continues to go down because our average consumption continues to go down just because of the awareness of water scarcity here and so people don't water their lawns when it doesn't need it. Like when it's raining they have sensitive sprinkler control systems that say OK my lawn does not need that now. So the GPCD, gallons per day capita, continues to really go down in most Western states just because of awareness of water. But our system can serve about 60000 single family home equivalents. So we compare it based on that, is the number of connections that we can provide service to. And that's a tremendous amount of money. So if you take a look at developing that system we typically get about 30000 dollars combined water and sewer tap fee for our portfolio. And so if you take 60000 units times 30000 dollars that's about 1.8 billion dollars in top line revenue that will allow us to provide service to our customers.

Mark: And then with that we build the facilities. We build the wells, we build the diversion, the reservoirs, the treatment facilities, the wastewater treatment plants that all provide that service. And then typically we get about \$1500 per connection per year. About \$1000 on the water side and about \$500 on the sewer side per connection per year. So if you look at that 60000 connections that translates into about 90 million dollars that build out year over year revenue. And so that's really our focal point of how the revenue comes into the company and then how we build the infrastructure attributable to providing service to that.

Mark: So today we have a network of wells and storage vehicles and pipelines and treatment facilities and wastewater treatment facilities that are serving really just a modest number of connections. We serve about 500 connections today. The developed capacity that we have has the capacity to serve closer to 2000. So we've got excess capacity but that capacity is being used. It's being used on an annual basis by our industrial customers. So in addition to providing water service to residential customers we also have a very burgeoning business of providing water to oil and gas industry for developing horizontal wells and fracking oil and gas wells right on top of where our water supplies are. And so we really flex into our infrastructure based on the demand and the needs of our customers.

Nate: I see. So I am curious, do you have wastewater treatment facilities that are operational today?

Mark: We do. We have one and are under construction for our second one. So we'll have by about a year from now we'll have two existing facilities. And so they're what we call zero discharge facilities. So 100 percent of what comes out of that wastewater treatment-

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Mark: -Discharge facilities. So 100 percent of what comes out of that wastewater treatment plant comes back to a reservoir and we reuse all of that water for our irrigation system. So we plumb our system so that a domestic line goes directly into the house and we have an irrigation line that will go to the parks and the open space and then on some of our industrial customers. So we do send raw water to our oil and gas clients that we can then use for fracking oil and gas wells.

- Nate: Okay. Okay that makes sense and so that 27000 acre feet of water, is that all underground? Is that all aquifer water? Or what are the water rights? I'm sorry. Maybe we should go back just a little bit. Water rights, is it underground? You mentioned reservoirs, is that just for the treated water that maybe people aren't going to be drinking or are there reservoirs out there, around here that you own that is also used for drinking water and for household use?
- Mark: So it's both. So really most providers here want to have a blend of two supplies. They want to have groundwater which is going to be aquifer water. And you also want to have surface water and the aquifers typically are viewed as nonrenewable. They do recharge. But we take water out of it faster than what's being recharged. So the proper way of using that aquifer is as a storage bucket and say I'm going to take water out and put water back in on that storage based on how the surface water flows come to your system. So we do have reservoirs, we do have stream flow surface water that flows in streams that we have water rights on. And so you might imagine in a particularly dry year, like this last year for example we had a very dry snowpack up until about May. Right. We were at 60 percent average annual snowpack until May came and then we had a lot of moisture in May that brought us back up to about 85 percent so it took away a lot of the drought restrictions.
- Mark: But the seasonal variability on surface water flows really put water providers in a bind and if you don't have storage, if you don't have groundwater that is in storage ready to go and you have a very dry year then you have a very limited supply. Conversely if you don't have surface water and just aquifer water you're mining your water and after a couple of hundred years you're going to be out of water. And so what you want to do is really balance them both out such that when you get a really wet year on your surface water you can store that, you can store that in your reservoirs, you can also store that down into your aquifer and so that you can keep that supply and use that in those dry years. And so that's what we have. We have a blend of surface water supplies, groundwater supplies, surface water storage to be able to take those surface water supplies in those peak flows, be able to store them, use them for our irrigation demands and then also be able to use them to store that water into the aquifer.
- Nate: Do you monitor the aquifer levels and does that fluctuate much? And I ask that question because my folks they live a little bit far away from the city and they have a well and they don't pay for their water, they just have a well in the backyard. And I remember it was about three or four years ago the well kind of sputtered out and they had to have somebody come out, re-drill another well to go even deeper because the water level had gone down so far. Do you have that situation here? And is that a risk or is aquifer levels is it pretty constant here in Colorado?
- Mark: We do monitor it very very closely and I will tell you it kind of depends on ... There's a way to drill a well that gives you sort of the maximum effect and then there's a way to drill a well that kind of gets you your job done. And so most domestic wells, not necessarily your parents wells, but most single family homes that drill a domestic well they drill until they hit water and then once they hit water they drill a few feet below that and that's where they set their pump. Well that's not necessarily the best place to set your pump. What you want to do is you want to find the full depth of the aquifer. And so maybe that aquifers 200 feet thick. And when you first drill your well, you hit it and then you drill for another 20 feet down in there because you're already in water. And that's where you end the well. As opposed to larger municipal wells where we'll drill all the way down to the bottom of that formation and we'll drill even farther down into that formation into the clay lands that is supporting that aquifer. Such that you have all 200 feet of column in there to be able to develop that water.

Mark: And so as that water level fluctuates over time you don't see that in your wells. So in the summer seasons you're going to draw that well down and then all winter long that well will fill back up and it'll equalize itself into that steady state of condition and so you don't have that variability when you go all the way to the bottom of the well. Not to say that these aquifers do have seasonal variations as well as long term variation. So that's why you want to be able to use that as a storage vehicle to be able to take water out. And what we call ASR, aquifer storage and recovery, to recharge those aquifers.

Nate: So could you talk about the development at Sky Ranch and could you talk about what that development means for Pure Cycle? And then I'm very curious how involved you were in that process of development or was it going back to what you were saying earlier about 70 providers of water to the city of Denver. Was it a bidding process when the developers decided Sky Ranch, this area, this many houses. Did you go in and was it a competitive process where you bid against other companies that are doing something similar?

Mark: Good question. So an interesting connection and a interesting tie between land use and water availability really has been matriculating through the state for the last 20 years. And so what we were finding was cities and municipalities were very aggressive about their annexations right. They would annex lots and lots of land far beyond the capacity for them to provide water and sewer services and give these land zonings and zonings that could never be built. You'd have thousands of homes be zoned on property that can never be built because they didn't have water supply. And so the state of Colorado got a little bit proactive about that back in the last real strong real estate cycle. So from the time frame maybe 2002 through 2004, '5 timeframe the state actually passed a statute that said hey we're going to try and curtail some of this aggressive annexation and zoning by cities and municipalities to be able to be more closely tied to capacities.

Mark: And so they said OK in order for you XYZ city to grant land use entitlements, you've got to demonstrate that you've got water supply to serve that. And so we were one of the first projects that came through as this statute passed in I want to say 2004 timeframe. And so what happened was that statute passed, none of these cities and municipalities knew what to do with that. They said well what do you mean by that. I mean some of these projects takes 50 years to develop. You can't be telling us we have to inventory something for 50 years, that's too cost prohibitive. I can't go buy that much water and not develop it for 50 years, it's impractical. And so they didn't know how to deal with it. And we had an opportunity where a developer had this particular property, they had a thousand acres which was in the right place, it was right along the interstate, it was just south of the airport.

Mark: They went to the local jurisdiction and said "Hey we want to build a masterplan community here." And they said "Ah, it's a great spot for it. We agree, we think that's great but where are you going to get your water?" And they said "Well we'll figure that out." And they said "Yeah, you're going to figure that out sooner rather than later. We can't give you that zoning until you figure that out." And so he said "Well what do you think?" And they said "Well go see Pure Cycle, they're a water provider. They happen to be our water provider and some of the installations that the county facilities themselves. We know them, we know their portfolio, if they would be interested in providing you water then we can consider your zoning." And so that's what we did. And so the interesting thing about it was they didn't know how to deal with this regulatory climate because we were the first ones to it. So what they ended up forcing us to do is they had a deed restrict a portion of our portfolio to match the zoning because the zoning is perpetually granted to a piece of property so they said "If you're going to be the service provider there you're going to have to be perpetually tied to that property."

Mark: Well at the time we thought that was a good idea and 2005, '6 timeframe that was a good idea. There was a ton of opportunity in the marketplace because housing was going great guns. This project was getting off the ground. And so we were happy to do that. And then all of a sudden 2007, 2008 hits and you had this big housing recession and what happened in this particular case was the owner of the property, the homebuilder that bought this property, went into bankruptcy. Well from 2008 through 2010 our water was tied to this piece of property that was now in bankruptcy and nobody was paying attention to the value that the water provided to the piece of property. And so we were looking at it on a corporate level and our board was sort of saying hey listen we think we're more right than we ever have been in terms of the value of water and how it will play to development because we can provide water incrementally, by increments I mean we can provide it one connection at a time.

Mark: If that builder wanted to buy one tap, they could buy one tap. Where a lot of masterplan communities have to come up front with a lot of infrastructure. They may have to buy several hundred taps worth of water in order for the city, municipality to be able to extend services to the property. And so we didn't have to do that because our service was right where that property was. So they said "What's your next great idea Mark because we've got to figure this out and we think housing is going to be kind of challenged for a few years?" And I said listen "You're going to kill me but I think we need to run into that burning building. We need to buy that land and vertically integrate ourselves because when we're providing one tap connection at a time it doesn't make our water system more valuable but it does make that land more valuable." And that was intuitively correct. So we took a look at that on an opportunistic basis to buy the land. So we did. We bought the land. I think we paid something like 7 million dollars for a piece of land that two years earlier sold for something like 50 million dollars. And so not only did we get the land-

Nate: The full 1000 acres?

Mark: The full 1000 acres. We had the water franchise utility and we got some mineral interest distributable to us. And so it really worked out to be a terrific acquisition for us. And so we never really intended to be a developer. We really were just protecting our assets and capitalizing on kind of the right buy decision for that. And then as the years went on ... So we closed that in say 2010, 2011 timeframe. And then we were waiting for the market to recover and then really the metro area continued its growth, continued to add new connections, new housing starts to its cycle and then it became evident that it was timely for that to be on the market. So I went out to most of the masterplan developers to find a relationship where I could partner with somebody to develop the property and then I would just do what we do best which is the water and the wastewater utilities. But as it turns out the two thirds of the hardest parts of land development are exactly what we already did, owning the land first and foremost.

Mark: And we bought that with equity so we had an ownership interest in providing utilities which we owned with equity so those two components were really two thirds of what we needed to do. That next increment was really no more different than what we had already seen in developing water utilities. And so never found the right fit for a developer to partner with us on that so we go ahead and became the developer for that. We're finishing lots and then delivering finished lot together with a wastewater utility. So we were really capitalizing on the value that water played in enhancing that real estate. And then that just became a real opportunistic ... I would say that's a bit of a one off for us because it may not be something that we aggressively pursue. It has worked out well for us but I'd say it worked out well for us because we bought right more than we're intuitively smart to be able to be a good developer. Good developers really are those that buy land correctly.

- Nate: Yeah. So looking through your slides I don't think, at least I don't recall seeing any sort of data points on how much you could sell a lot for. So you still you're developing the Sky Ranch property.
- Mark: Right.
- Nate: You're going to have streets that ... I haven't seen it yet but are there streets already there that are-
- Mark: There are.
- Nate: Okay and so there will be houses that go up. Do you collect a margin on somebody else going to ... How does that ... I'm really curious how does that part of the business work because it seems like it's a water business that we're focusing on but-
- Mark: So we do develop finished lots for a homebuilder, then they come in and they go vertical with the house. And so in that process we have to grade out the lot, we have to build the roads, curbs and gutters. So those are the aspects of the land development side. We would have otherwise been building the water and sewer, water utilities of that and then we just layer on to that some of the surface infrastructure as well. And so we're under contract now. So we're starting our first phase on that. The 1000 acres in whole will probably serve about 5000 connections. So when you look at our 60000 connection potential this is really just a small fraction, call it 12 percent of our overall supply, that we have available.
- Mark: And of the 5000 connections we're leading with our first 500. So what we're grading out now is 500 lots and we have sold all 500 lots. We've sold them to 3 master builders. We've got Richmond, Kaybee and Taylor Morrison is our three portfolio home builders out there and we're delivering those lots. We should be in a position of having our first lot deliveries for model homes sort of in the fall timeframe, maybe October, late October timeframe. And they'll start construction of those. The way it works is we sold those lots for about \$70000 dollars a finished lot. So if you look at the first 500 times that, that's about 35 million dollars worth of lot land sale revenue. And it costs us about \$50,000 to deliver a lot so I'll make a margin of about \$20,000 per lot of delivering those finished lots to that first phase of that. And then on top of the \$70,000 we do a tap fee and so our tap fee will be a \$30,000 tap fee now.
- Mark: What we've also tried to do to be reactive of the market is to recognize that homes and lots are becoming smaller. Denver Colorado as a whole has a very significant affordability problem. So it's very difficult to find an entry level home and it's staggering to say an entry level home in Colorado is \$300,000. But that's kind of our target is to be in that entry level market so these homes are likely to be a little bit smaller. And so we'll see, we've got a way to calculate tap fees based on the actual water consumption. So if they're not using a 0.4 acre feet, they're paying the equivalent of a 0.4 cost but we may instead of being able to serve two and a half homes per acre foot maybe we can serve three and a half homes per acre foot. So we have a way to calculate water availability based on the actual consumptive demand of each individual lot, each individual house.
- Nate: So the phase one that incorporates how much of the 1000 acres that you own-?
- Mark: So it's the first 150 acres.
- Nate: First 150 acres. And how many phases are there for Sky Ranch?

Mark: We'll probably chop this up into four different phases. So we'll have this first phase then the next phase will be kind of two sub-phases. A commercial phase because we're right up along the interstate with an interchange. So there'll be about 160 acres of commercial uses and they'll be a mix of retail, commercial uses, grocery, big box stores, light manufacturing or employment centers, maybe some light industrial just so you can have some warehouse space and things like that up at the interstate. Then the next say 360 acres is going to be all residential, it'll be a mix of residential. This is very specific detached single family in this next phase. We'll include more of that, it will include some multifamily, it'll include some apartment complexes, some paired product, a whole different range of products. Where we have three builders in this phase, we may have six or seven different types of builders in the second phase of this. And we will have 500 homes in this one. Our next phase will be about 2500 homes.

Nate: 2500 homes, okay. So then you'll be at the 3000 sort of level and then you've got 3000 more homes or at least a capacity.

Mark: Maybe 2000.

Nate: Okay, 2000 more. Could you talk about what are the risks to get you there? I mean what are you concerned about going forward?

Mark: So owning the land is very helpful. We can sustain ourselves through cyclical natures of a market. We're in a very good market right now and I think that market looks to stay strong for a predictable future and I don't know what that predictable future is. I mean I can barely figure out what I'm going to have for lunch tomorrow let alone what the housing market's going to do for the next five years. But I think we're pretty solid for the next three years on that. We want to structure our inventory so we don't overbuild capacity in our road network, our drainage network, or our water or sewer network before we have lot sales to be able to deliver that. So again I'd like to describe this as an inventory management business because we can buy water and that's a very high barrier entry, very costly to get into that business.

Mark: But then ultimately you want to build that infrastructure concurrent with the demand for that. And it's very similar in the land development business. You don't want to build too much in inventory, too much land or too many lots because builders will only buy what they can sell lots for. So I think we've been able to manage that very well with the fact that we own the land and the utilities upfront. And so those are the hard components of it and delivering that last component, you can do that in more real time. So we want to be real time in delivering those lots. If you look at a typical masterplan community those are 10 to 12 year build out cycles so we look at Sky Ranch there's 5000 overall connections out there between the residential and the commercial connections out there.

Mark: So that's going to take some time to absorb. Masterplan builders typically like to be in projects where they get about a 2 to 3 year inventory so they want to be in a position where they can build eight to 10 homes a month. And so if you have three builders on one phase and they're all doing 10 homes a month, 500 homes is about two years worth of supply. So they're going to be aggressive about it because they want to make sure that they maintain their absorptions on it. And then as you expand into your next phase you might have more builders than that so you may see a little bit higher absorptions. And you may have the tail end of the first phase going on when you have the front end of the second phase going on. So you're going to see a lot of activity.

Mark: And so that will be just one project. Then we have opportunities where we're looking at starting other projects. Either on other service areas that we have at Loughry or surrounding service areas that we have with property owners that need additional water supplies. So those are some of the things that we've got our nets cast out for other opportunities and expanding our regional service.

Nate: Yeah. And so the Phase two, what's the timing around that?

Mark: So we're doing the land plan for that now. So it will be in front of our entitlement agency which is Rabel county this summer on some of the preliminary revisions to the land plan for what the market's telling us today, what with the builders want. We do have our zoning. So from the zoning standpoint then you drill down into okay what type of mix of products do we need and our builders are saying hey we want more of this, we want you to try some of this product because we don't have that in our first phase but we want it in our second phase. And even some of the builders that aren't in the first phase have come to us and say "Hey I missed out on the first phase but I'd really like to be in the second phase and I'd like to take a look at this type of product if you can incorporate that into your design." So we're doing that right now.

Nate: So industrial water sales it's primarily oil and gas. Is that correct?

Mark: It is. It is. Primarily oil. This is kind of a oil heavy part of the basin and it's in a oil shale area where it's sort of rock that previously nobody thought would be economic to generate oil on and somebody drilled a well into it, went horizontal and fracked it and found "Oh my gosh. These are really terrific producing wells." And so it started up in sort of Northern Colorado in that basin called the Niobrara formation and then they didn't know where the bounds of that were. And so as that started to creep south then what we found is I ended up buying the Sky Ranch property and I will tell you not 15 days after we filed that we were the record owner of the property I started getting calls from oil and gas companies.

Mark: And it wasn't Bob's landman right, this was so-and-so from Anadarko, so-and-so from Conoco, so-and-so from Chesapeake. I mean these were direct companies that were no bones about it. We have an economic interest in here. We think that this is a great area, we'd like to lease your minerals. And my first question was then, do I own them, and they said as a matter of fact you do. And so I said terrific. So we ended up originally leasing to Anadarko and Anadarko and Conoco did a deal to share mineral positions and consolidate positions. And so Conoco has been the predominant provider or the predominant E&P drilling and exploration company for what we're doing here.

Mark: And what we know is this is a very attractive field where we are at and it turned out to be absolutely fortuitous to be right on top of where our water supplies are. And one of the critical things that they need in that is they need water, they need water to transport that sand into the formation to hold those fracks open and be able to let that oil release into the well. And so the interesting component about it is that they're a very good customer for us, they're a very peak customer for us. To give you an illustration, one well that they frack is the equivalent of us selling water to 100 homes for a year and they do that in five days. So we see a huge compression selling water to the oil and gas industry. And we do it as sensitive as possible. So what happens is we have a buried infrastructure that transports our water to delivery points and they connect to that system. They put a flex hose on the ground to the pad site so they don't have to truck the water in, they don't have traffic problems with the water, they don't have all those transport problems. It goes directly from our system to the well, down into the hole and then they are able to use it for their purpose.

Mark: Some of that water does come back out of the well. It's very very briny. So this is a mineral, a marine deposit is what this is. So this is all organic marine life that in Colorado at some point was at the bottom of the ocean. And so it comes back very very briny, 35 parts per million, seawater is about 30,000 parts per million. So this is very very briny. So this is what we call a disposal friendly state. So we don't want to treat that water, we can't treat that water, we can't bring that back to a really high quality water supply. So we don't, the industry as a whole has disposal wells. We don't participate in that field. That's an oil field services company that typically does that. So we just sell it to them on the front end. They deliver it to the well themselves and then they are responsible for it once it comes back out of the well.

Nate: So do they truck it very far distances or do you have sort of a limited geography in terms of how many oil and gas customers you can serve?

Mark: Yeah so they don't truck it at-

PART 2 OF 3 ENDS [00:52:04]

Nate: ... there's oil and gas customers you can serve.

Mark: Yeah, so they don't truck it at all from our supply. They run it from a direct line onto the well pad side. The produced water, flow back water and the produced water what a lot of the providers are doing is when they build their oil and gas collection lines they also build a produced water line, and that produced water line will transport it to a central facility and then they have a disposal well at that central facility, so they minimize what they have to truck.

Nate: So I guess what I'm trying to get at is how many potential drilling sites do you have? Are you connected to currently?

Mark: Good question. So if you take a look at just, and I'll just put a footprint, there's 130,000 acres that Conoco had leased up. There's other providers that have a broader footprint than that, that we would be providing service to, but even just at 130,000 acres, if you look at why this is so attractive. This is attractive because it has as many as five different lenses that they can put individual wells on, and so they drill separate wells into each of those five productive lenses and they drill them out at 40 acre spacings. So if you do the math on that for 130,000 acres that can be as many as 16,000 wells in this field, and that's just one operator so there are other operators here.

Mark: And so if we're selling water to them and typically what we're selling them we generate about \$150,000 per well on that, that's billions of dollars of frack water revenue for them, and it's a lot of water that we're delivering to the industry and so we're sensitive about making sure that we're a good provider for them and it does a lot for them. I mean \$150,000 out of a \$3 million well is insignificant in the overall cost of the well, but still it's a very sensitive area for oil and gas to make sure that they have that kind of volume of water.

Mark: And then what you'll see is you'll see a lot of refracks of these as these start to age into it they can come back in, they can refrack that well and bring back that initial production up to a higher level and then continue to just mine the oil, mine the hydrocarbons. So what we're basically doing is using water that ... If it took us 40 years to build 60,000 homes worth of water utility out in this area, I'm taking that and some of those annual

demand revenues 30 years from now being able to use them now for oil and gas, without compromising the ability to still provide water to 60,000 homes.

Nate: That's phenomenal, and what about the oil and gas royalties, how much of your cash flows are royalties today?

Mark: Very limited. I will say that they're nice to have because that's 100% margin. We don't even have to bring a check to the bank, they just do it direct deposit for us. So yeah, we do have one well that pools our mineral interest and it happened to be ... Everybody always tells you the great story, right? They sort of say, "Hey, that's our best well," and I think it is their best well but at the end of the day we're almost four years into it, we still don't have a pumpjack. It's still what we call a gas driven well, so it flows from gas pressure itself on the well. It's initial production was around 2,000 barrels a day, it's declined out we're generating about \$25,000 a month.

Mark: So it's not a huge revenue stream for us but it's only one well we could have as many as 60 wells that pool that interest to get that mineral estate that we got with Sky Ranch fully developed.

Nate: So what are your costs? What are your expenses every month?

Mark: So typically when you look at delivering water and wastewater service, so there's a capital component and operating component. The capital component is really where we fund that through the tap fees, right? That's the money that builds the system that diverse the wells, the pipes, the treatment facilities that do that, and so also in that capital component is the value of the water, and so where we own that in equity that gives us huge leverage in that, where I'm not ... I get returns for that because we're very long and very early in that water supply but because of that leverage in three our margins in the capital side are about 50%.

Mark: So when I get a \$30,000 tap fee we earmark about 50% of that for covering the physical brick and mortar of building the system, and then the operating revenue. So we send water and process wastewater on a monthly basis, we get paid to do that and that's typically also about a 50% margin business because there's still value in the water resource itself. So when you look at it, while we have very high margins those high margins are attributable to those assets that we have held for a very long time, which is the water supply, that scarcity value which give us very high margins in there.

Mark: When you take a look at the oil and gas industry, they're not paying for the tap fee they're just paying the operational side of that, so our margins are probably even a little more favorable on the oil and gas side, just because we advance the capital for that on the front end, and so we're getting a return on sort of that capital that we've put into play over the last 30 years, so those margins are maybe 60, 65% on the oil and gas side.

Nate: And just in terms of your ability to increase price for your residential customers, is that something that ... You mentioned this isn't really regulated, but can you raise price with inflation? Could you just talk about the price dynamics.

Mark: And we do. We do take a look at that on an annual basis and we reassess our tap fees, the capital component fee as well as the operating fees, and on the operating fees we try to keep pace with sort of the cost of operating that stuff, pipeline costs, chemical costs, electrical costs, those sorts of things that normally layer into that. We want to make sure that we keep pace with that to maintain our margins in the service side of

it. On the capital side it's competitive, so if tap fees go up 50% for example from 30 to \$45,000 a year, there are many water providers in the metro area that offer tap fees for 45,000.

Mark: So there is pricing leverage on the capital side because ultimately if a developer says, "Hey, it's more valuable from you to serve my property than the neighboring property, I want that commitment from you, and I want a piece of your portfolio to be able to do that." We have pricing potential in that area.

Nate: Yeah okay, and so are there areas outside of Sky Ranch and oil and gas that you can sell water?

Mark: Yes, so I mean Sky Ranch, we only did one well there. I mean all 130,000 acres we have about a 20 mile by 20 mile footprint that we're providing water to, so they can transfer water on a very significant wide field of opportunity for us. It gets us many thousands of oil well potential. And it's going to be a business that's going to be very steady for us for decades. It's going to be a long-term customer for us for 40 years.

Nate: So, but I mean outside of oiling ... You mention 130,000 are you referencing Conoco's?

Mark: Yeah, that's Conoco's footprint but there's others. Anadarko has a footprint in there. Extraction has a footprint in there. A number of providers all have footprints on top of where we can deliver water.

Nate: Okay, and then just in terms of new developments you just can go in and bid for whatever new development shows up around here and-

Mark: That's right.

Nate: Okay.

Mark: We're working with landowners and large developers that say, "Hey listen, I want to build this. It cost this much in water. I need this much acre-feet of water." How can we get our system extended to provide service to your property?

Nate: Yeah, so what would the cash flow profile of Pure Cycle look like if you fast forward six, seven years from now and you've got 5,000 homes in Sky Ranch and Conoco is drilling maybe plus or minus 10% relative today, what would the cash flow profile look like for Pure Cycle?

Mark: So a couple of things, if you just break Sky Ranch down all by itself, if I have 5,000 connections out of Sky Ranch and I'm going to do \$100,000 per connection on the capital side, which is a combination of the land value and the water utility franchise, that's \$500 million worth of revenue and that's just Sky Ranch, that's just the residential stuff, and then on an operating basis we're going to be delivering water to 5,000 connections. So at \$1,500 per connection that's \$7.5 million year over year revenue.

Mark: We're vertically integrated. We have that within our full control, and then sort of we'll still be adding other connections to that so there'll be other Sky Ranches that are starting in that same time frame, so look at that and say on an annual basis we may be getting a thousand connections a year through various projects of the water franchise, the water utility business at \$30,000 per connection that's \$30 million a year. If I'm getting a thousand connections a year I got 60 years worth of that. So it doesn't go straight line on that, it's probably a bell curve that goes, where it starts out at a few hundred, goes to a few thousand and then tapers back

down, so you see that there's a real surge of how we're adding big revenue streams to the company, and then there's the trailing revenue.

Mark: So we get that \$1,500 per connection per year so I build out we are at 90 million, so when you're getting all those tap fee revenues you're getting that consumption on the back end, those connections on a perpetual basis, and then the oil and gas. So Conoco is doing 30 wells this year, and we may have two or three operators doing 30 wells, so call it a hundred wells and if I'm making 150, 200 grand per well that's 15 to 20 million dollars a year for 40 years of oil and gas operations that are compounding on top of what it is that we're doing on the water utility side of it, so it starts to ramp very quickly.

Nate: You could be generating a lot of cash flow in the future, and it looks like you will be generating a lot of cash flow in the future, and so then the next question is what are you going to do with that cash? Do you have an M&A strategy? Do you have a shareholder return story that you'd like to share?

Mark: Great question, high-quality problem. We really do ... and we're thoughtful about that. So let me give you sort of my philosophy and where I think our board's heads are at right now is that there is some M&A opportunities out there, and the opportunities that we like are where we can go in and we can buy, take over, operate a water utility, small water utility that's probably homeowner association driven or developer driven that isn't professionally managed. Somebody goes out and just pays attention to it on a weekly basis but they are in need of professional operation of their system, and we did one of those. We did one of those last year with this wild point system which was a small system.

Mark: It was probably 60% built out, still had 40% still yet to build out, so we went in and we took that system over, spent a million and a half dollars for it and it has probably two and a half million dollars in tap fee revenue available to it, and then at build-out maybe \$400,000 a year, year over year revenue attributable to operating the water system out there. But there are lots of systems out there like that, so there's a consolidation opportunity, rolling up some of those, and the ones we like are the ones where we can bring our water to an equation that helps in the equation, right? To a community that says ...

Mark: And I'll give you a made-up example. There's a community out there that has a thousand connections that has annexed and zoned historically another 4,000 connections, right? So they have 5,000 connection total and the total assess value, the total combined value of the entire thousand homes doesn't add up enough to be able to go out and buy water for the next 4,000 connections, so they have this very challenging problem. They can't get water supply because it's so expensive, and so that's a situation where we can go in and we can bring our water to the next 4,000 connections as well as provide them professional management on the first thousand connections, so those are the types of opportunities that we're looking for.

Mark: So that's first and foremost, acquisition opportunities, where we think we can put that capital to better use to generate more revenue, more combined return capacity for our shareholders. Second philosophy is everybody wants a water utility because it's a dividend play, right? And that's certainly where we want to be. We want to be in a position where we can declare annual dividends. We like annual dividends out of cash flow not out of capital revenue, so as our annual revenues from our industrial customers and our existing connections get to a maturity point where we can declare dividends, we have the capacity to do that.

Mark: And then finally if the market doesn't have a good value for where our shares are, there's buyback opportunities to be able to buy shares back and be able to return that value to shareholders by increasing

the share value by lowering the denominator. So in increasing layers of priority those are the dividend and the buyback may switch depending on how opportunities exist for us in the marketplace, and how people are recognizing shareholder value or the timing of shareholder value but that's kind of how we look at what to do with that capital base.

Nate: Well with cash flows expected to ramp like they are, the way that you described your business in the future your valuation today doesn't seem to reflect that outlook and so you've got 20 almost 10% of your market cap is in cash on the balance sheet. Why wouldn't you just buy back shares today?

Mark: Good question, ultimately we've got a couple of big projects that we've bit off, so I want to digest that before I get overly confident. I don't get too far over my skis on stuff because you never know in the marketplace. We could go out. We could do a buyback. We have capacity. We have the strong balance sheet to be able to do that but we're sensitive to taking on a big inventory of lots right now, and so as those start to generate cash flow back to us we want to be considerate of that timing on that.

Nate: And you don't have any debt today, what are your thoughts around leveraging up a little bit?

Mark: We should. I mean there's always a better ... Certainly more leveraging up than changing the denominator and shares outstanding. I like the capacity that we have, very valuable, highly appreciated assets that do carry a lot of leverage potential for us. So when we see an opportunity whether that's an acquisition or a water supply or municipality that we can deliver infrastructure to then ... that exceeds the cash capacity or a combination of some debt and some cash.

Nate: Yeah, it's a thought process similar to the dividend. You want to have a reoccurring revenue stream first before, so you can pay down interest as expense, is it that type of thing or is it-

Mark: Banks are funny, and you look at traditional banking it's very challenge for them because they're not in the risk business at all, so it's harder pre or post banking crisis to be in a position of having the normal traditional banking sources look at lending opportunities. I think the investor market is going to fill that void much more quickly than the banking industry is. To be able to come in and look at companies like ours that have current cash flows highly valued assets and then will lend into growing cash flows in that.

Mark: When we talk to our banks the conservative nature of a bank is give me a dollar and I'll loan you 90 cents, and so I think that there's a better profile for that, and I'm over-exaggerating I think the Wells Fargo's of the world are, but at the end of the day there is a debt relationship out there that I think leverages companies to be able to show those cash flows as well as contracts, where we have contracts for the sale of a couple thousand lots and that could generate a couple hundred million dollars over this period of time. Those are the types of lending opportunities that the company would be very well-suited for.

Nate: Yeah, okay. Knowing what about your business, if you weren't a shareholder what would you focus on most acutely in terms of just getting comfortable with the investment thesis?

Mark: So what we were right on, on a lot of these areas is the value of water increasing. We have held that water for a very long time, the water has increased in value. The challenge for us has been it hasn't been recognized. It doesn't generate current cash flow so there's a gap between holding it and monetizing it. I think the market

has been kind to us to allow us the latitude to do that but sometimes the public vehicle of doing that is less patient than maybe private side of that.

Mark: So why are we public? When you take a look at it. We're a thinly traded stock. We're institutionally held. We don't take advantage of any of the equity market. My last raise was in 2010. I pay a ton of money for stock exchange and SEC compliance and all that stuff. I'd probably look at that at a different model. 30 years ago, you had to be public to access capital, today they'd prefer you not be public. So I probably look at that as to say we spend a lot of money and don't get a lot of value out of being public, but that also presents an opportunity for people, right?

Mark: You can come in and you can say, "Wow, here's a company that I can get into with low barrier and I can buy a share. I can buy a hundred shares I can buy a million shares." So that flexibility is there, and I think it will catch up, and it certainly advantages the people that take a look at it, that do the work and sort of see where it is that we're at, where we've come from, what that runway looks like for us and then figure out that this might be a great opportunity.

Mark: I try not to manage the business quarter-over-quarter. You can't do that, and companies that try to do that have a different business model, utilities don't present themselves well to do that because it just doesn't change that quickly, but when that ball gets rolling it's very very difficult to change that momentum.

Nate: Two last quick questions. First one is, what are the appropriate valuation metrics for Pure Cycle today? You've mentioned quite a bit the utility model, Pure Cycle is like a utility so maybe in the outer years when you're paying a dividend and cash flows are more consistent then utility metrics would be appropriate, dividend yield, P/E multiples, what about today?

Mark: So it's usually a discount cash flow analysis. As much as I'd like to say that it's not, this really is finance 101. When you have a core asset-based company and you can appreciate that these assets will transfer into a particular service model, and that there are very few competitive factors that will change that. It's a timing element, right? Because it's not a trend analysis. It's not a momentum play. It's not, capitalize on this particular market segment or technology, none of that stuff applies here.

Mark: And so what you really do is you sort of say, "If I can serve 60,000 connections with this portfolio, and I've got a 50% margin on the capital side, I can do any number of sensitivity analysis as to how long it's going to take them to add 60,000 homes." That's a billion eight on that side, and you can say, "Well tap fees are going to go up with some amounts. I can do some inflation. I can do some tap fees sensitivities. I can discount that back," and then you also take a look at, there's this other big segment in oil and gas.

Mark: I've got 16,000 well potential and they're selling it for 150,000 that might creep up and present value that back, and maybe it's not 16,000 wells maybe it's 30,000 wells because they get multiple fracks in those. So you start to look at that and say it's easy enough for you to run that out over a model basis and then take a look at that denominator and say, "Okay, what's that going to look like."

Nate: Yeah, that's helpful. So last question, and it's something that I try to end all of these interviews with. So it's just, I ask the question, a funny or interesting story that you'd be willing to share on sell-side conference or an investor meeting that you just walked away from and it just sticks with you and it's something that was either humorous or interesting.

Mark: This was maybe 15 years ago and I was kind of just getting into the circuit of water conferences, right? And so there's a few folks that are industry analysts in this business, and there was a guy at the time, Deane dray who was with Goldman Sachs at the time, and here I'm a hundred million dollar water company, and he happened to hear me at a water conference, and he says, "Oh my god, you're so different than every other CEO of water utility companies. These guys just talk about, this is what they did last year, and this is what they're going to do this year, and they've been paying a dividend for 250 years, and they're interesting investments but they just don't talk very dynamically about water,"

Mark: And he said, "I loved what you had to say," and he said, "You're really knowledgeable about water supply, and water supply is so dynamic." And so here's this young guy with a hundred million dollar market cap, and I get invited to be the keynote speaker at a Goldman Sachs conference.

Nate: Oh wow.

Mark: And so it was just phenomenal. It was a room full of super intelligent people, very smart investors. When you start on your lunch and it's interesting to see how a presentation at lunch goes, right? So you start your presentations very clanky, nobody is really paying attention. They're all looking at their rubber chicken or whatever it is that they have for the meal, and then about 10 minutes into it you don't hear much clanging anymore, and people aren't done eating they just stopped eating and they started listening.

Mark: And so I felt that that was kind of a turning point in the industry where people said, "Wait a minute," and it wasn't because of me. I think people attending we're trying to figure out water. Value of the commodity, not the utility but how do you understand that water is a real property interest.

Nate: Yeah that's fascinating. My wife comes home every day and she has a different story about water treatment or just something that she's doing, and it is a really fascinating subject.

Mark: It's invisible. When we're doing our job well, nobody even knows that there's a whole industry that supports this, you know what I mean? John Q. Public appreciates that they can turn on their tap and flush their toilet but there's a whole army of people that make it so that you don't even have to think about it.

Nate: Yeah, well Mark thank you so very much for coming on to the podcast. It's been a pleasure talking to you.

Mark: Is a delight. I appreciate the opportunity and best of luck.

Nate: Yeah, thank you very much. Have a good one.

Mark: Take care.

Nate: Alright.

PART 3 OF 3 ENDS [01:16:31]

Company: Pure Cycle Corp
Ticker: PCYO
GICS Sector: Utilities
Date: 6/17/2018

Market Cap: \$230M
Cash & Equivalents: \$20.2M
Total Debt: \$0M
Enterprise Value: \$210M

Price: \$9.65
2019 P/E: n/a
2019 EV/EBITDA: n/a
2019 Div Yield: n/a

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