

PURE CYCLE CORP
Form 10-Q
July 09, 2010

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: May 31, 2010
or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____
Commission file number 0-8814
PURE CYCLE CORPORATION
(Exact name of registrant as specified in its charter)

Colorado

84-0705083

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

500 E. 8th Ave, Suite 201, Denver, CO

80203

(Address of principal executive offices)

(Zip Code)

(303) 292 3456

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

(Do not check if a smaller reporting company)

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

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of July 7, 2010:

Common stock, 1/3 of \$.01 par value

20,206,566

(Class)

(Number of Shares)

PURE CYCLE CORPORATION
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PURE CYCLE CORPORATION
BALANCE SHEETS

	May 31, 2010 (unaudited)	August 31, 2009
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 527,334	\$ 705,083
Marketable securities	2,022,589	3,002,208
Trade accounts receivable	55,876	63,394
Prepaid expenses	219,923	154,928
Current portion of construction proceeds receivable	64,783	64,783
 Total current assets	 2,890,505	 3,990,396
 Investments in water and water systems, net	 102,894,409	 103,159,632
 Construction proceeds receivable, less current portion	 372,919	 414,494
Note receivable, including interest from related party	516,800	507,795
Other assets	22,334	18,764
 Total assets	 \$ 106,696,967	 \$ 108,091,081
 LIABILITIES:		
Current liabilities:		
Accounts payable	\$ 44,178	\$ 22,216
Accrued liabilities	67,151	60,080
Deferred revenues	55,800	55,800
 Total current liabilities	 167,129	 138,096
 Deferred revenues, less current portion	 1,404,256	 1,446,108
Participating Interests in Export Water Supply	1,215,376	1,216,360
Tap Participation Fee payable to HP A&M, net of \$52.9 million and \$55.6 million discount	60,215,329	57,521,329
 Total liabilities	 63,002,090	 60,321,893
 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:	67,360	67,360

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Par value 1/3 of \$.01 per share, 40 million shares authorized; 20,206,566 shares
outstanding

Additional paid-in capital	92,309,783	92,253,916
Accumulated comprehensive income	171	3,986
Accumulated deficit	(48,682,870)	(44,556,507)
Total shareholders' equity	43,694,877	47,769,188
Total liabilities and shareholders' equity	\$ 106,696,967	\$ 108,091,081

See Accompanying Notes to Financial Statements

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PURE CYCLE CORPORATION
STATEMENTS OF OPERATIONS
(unaudited)

	Three months ended:	
	May 31, 2010	May 31, 2009
Revenues:		
Metered water usage	\$ 27,269	\$ 31,820
Wastewater treatment fees	16,744	16,744
Recognition of deferred revenues:		
Special facility funding	10,377	10,377
Water tap fees	3,574	3,574
Total revenues	57,964	62,515
Cost of revenues:		
Water service operations	(7,763)	(10,232)
Wastewater service operations	(5,763)	(4,495)
Depletion and depreciation	(22,102)	(22,131)
Total cost of revenues	(35,628)	(36,858)
Gross margin	22,336	25,657
Expenses:		
General and administrative expenses	(387,344)	(455,532)
Depreciation	(74,593)	(73,243)
Operating loss	(439,601)	(503,118)
Other income (expense):		
Interest income	18,211	12,863
Gain on sale of land		22,172
Other	12	880
Interest imputed on the Tap Participation Fee payable to HP A&M	(912,000)	(858,000)
Net loss	\$ (1,333,378)	\$ (1,325,203)
Net loss per common share basic and diluted	\$ (0.07)	\$ (0.07)
Weighted average common shares outstanding basic and diluted	20,206,566	20,206,566

See Accompanying Notes to Financial Statements

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PURE CYCLE CORPORATION
STATEMENTS OF OPERATIONS
(unaudited)

	Nine months Ended:	
	May 31, 2010	May 31, 2009
Revenues:		
Metered water usage	\$ 76,664	\$ 88,354
Wastewater treatment fees	50,232	50,232
Recognition of deferred revenues:		
Special facility funding	31,131	31,131
Water tap fees	10,722	10,722
Total revenues	168,749	180,439
Cost of revenues:		
Water service operations	(33,182)	(37,973)
Wastewater service operations	(16,202)	(16,113)
Depletion and depreciation	(66,256)	(66,338)
Total cost of revenues	(115,640)	(120,424)
Gross margin	53,109	60,015
Expenses:		
General and administrative expenses	(1,327,520)	(1,547,922)
Depreciation	(223,883)	(218,808)
Operating loss	(1,498,294)	(1,706,715)
Other income (expense):		
Interest income	55,384	70,481
Gain on sale of land	9,404	59,671
Land use payment		5,000
Other	1,143	(4,976)
Interest imputed on the Tap Participation Fee payable to HP A&M	(2,694,000)	(2,862,000)
Net loss	\$ (4,126,363)	\$ (4,438,539)
Net loss per common share basic and diluted	\$ (0.20)	\$ (0.22)
Weighted average common shares outstanding basic and diluted	20,206,566	20,206,566

See Accompanying Notes to Financial Statements

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PURE CYCLE CORPORATION
STATEMENTS OF CASH FLOWS
(unaudited)

	Nine months ended:	
	May 31, 2010	May 31, 2009
Cash flows from operating activities:		
Net loss	\$ (4,126,363)	\$ (4,438,539)
Adjustments to reconcile net loss to net cash used for operating activities:		
Imputed interest on Tap Participation Fee payable to HP A&M	2,694,000	2,862,000
Depreciation, depletion and other non-cash items	291,373	286,119
Stock-based compensation expense included with general and administrative expenses	55,867	218,505
Interest income and other non-cash items	(28,510)	(25,642)
Gain on sale of land	(9,404)	(59,671)
Changes in operating assets and liabilities:		
Trade accounts receivable	7,518	25,148
Interest receivable and prepaid expenses	(64,995)	(84,677)
Accounts payable and accrued liabilities	29,033	11,699
Deferred revenues	(41,852)	(41,852)
Net cash used by operating activities	(1,193,333)	(1,246,910)
Cash flows from investing activities:		
Proceeds from sale of land	10,000	59,671
Issuance of note to Well Enhancement and Recovery Systems LLC		(7,000)
Purchase of property and equipment		(12,703)
Investments in water and water systems	(19,649)	(110,354)
Purchase of marketable securities		(2,997,000)
Investment in Well Enhancement and Recovery Systems LLC	(10,000)	
Maturities of marketable securities	975,804	
Net cash provided (used) by investing activities	956,155	(3,067,386)
Cash flows from financing activities:		
Arapahoe County construction proceeds	61,647	61,647
Payments to contingent liability holders	(2,218)	(1,944)
Tap Participation Fee payments to High Plains A&M		(37,499)
Net cash provided by financing activities	59,429	22,204
Net change in cash and cash equivalents	(177,749)	(4,292,092)
Cash and cash equivalents beginning of year	705,083	5,238,973
Cash and cash equivalents end of year	\$ 527,334	\$ 946,881

See Accompanying Notes to Financial Statements

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PURE CYCLE CORPORATION
NOTES TO FINANCIAL STATEMENTS
MAY 31, 2010

NOTE 1 PRESENTATION OF INTERIM INFORMATION

The May 31, 2010 balance sheet, the statements of operations for the three and nine months ended May 31, 2010 and 2009, and the statements of cash flows for the nine months ended May 31, 2010 and 2009, respectively, have been prepared by Pure Cycle Corporation (the Company) and have not been audited. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary to present fairly the financial position, results of operations and cash flows at May 31, 2010, and for all periods presented have been made appropriately.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company's 2009 Annual Report on Form 10-K filed with the Securities and Exchange Commission on November 13, 2009. The results of operations for interim periods presented are not necessarily indicative of the operating results for the full year.

The August 31, 2009 balance sheet was taken directly from the Company's audited financial statements.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the 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 federally insured high quality financial institution. At various times throughout the nine months ended May 31, 2010, cash deposits have exceeded federally insured limits.

Marketable Securities

At May 31, 2010 and August 31, 2009, the Company's marketable securities were comprised entirely of certificates of deposit maintained at various federally insured financial institutions, each of which have invested balances below federally insured limits and pay interest at stated rates through maturity. The certificates mature at various dates through March 2011; however, these securities represent temporary investments and it is management's intent to hold these securities available for current operations and not hold them until maturity, therefore they are classified as available-for-sale securities and are recorded at fair value. Any unrecognized changes in the fair value of these marketable securities is included as a component of accumulated comprehensive income (loss). The Company has no investments in equity instruments.

There were no gross realized gains or losses recorded during the three or nine months ended May 31, 2010 or 2009.

Tap Participation Fee payable to HP A&M

Pursuant to the Asset Purchase Agreement (the Arkansas River Agreement) dated August 31, 2006, the Company granted High Plains A&M, LLC (HP A&M) the right to receive ten percent (10%) of the Company's gross proceeds, or the equivalent thereof, from the sale of the next 40,000 water taps sold by the Company from and after the date of the Arkansas River Agreement (the Tap Participation Fee). The 40,000 figure was reduced to 39,470 at the August 31, 2006 closing date because HP A&M sold certain assets and properties which were subject to the Arkansas River Agreement and were available for credit against the Tap Participation Fee. The 39,470 figure was reduced to 38,965 during the fiscal year ended August 31, 2007, when the Company sold 509 Lower Arkansas Water Management Association (LAWMA) shares for approximately \$849,700 (as described in Note 4 to the Company's 2009 Annual Report on Form 10-K). Pursuant to the Arkansas River Agreement, 100% of the proceeds from the sale of the LAWMA shares were required to be paid to HP A&M, which resulted in a credit to the Tap Participation Fee equivalent to the sale of 505 water taps. The 38,965 figure was reduced by 28 water taps to 38,937 taps as a result of the sale of non-irrigated land during the fiscal year ended August 31, 2009 (as described in Note 4 to the Company's

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2009 Annual Report on Form 10-K). Pursuant to the Arkansas River Agreement, 100% of the proceeds from the sale of the non-irrigated land were required to be paid to HP A&M, which resulted in a credit to the Tap Participation Fee equivalent to the sale of 28 water taps.

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PURE CYCLE CORPORATION
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MAY 31, 2010

The Tap Participation Fee 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 three or nine months ended May 31, 2010 or 2009.

The Tap Participation Fee was initially valued at approximately \$45.6 million at the acquisition date using a discounted cash flow analysis of the projected future payments to HP A&M. The \$60.2 million balance at May 31, 2010, includes approximately \$15.5 million of imputed interest, recorded using the effective interest method. The Company estimates the value of the Tap Participation Fee by projecting new home development in the Company's targeted 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, Colorado metropolitan area applied to an estimated development pattern supported by historical development patterns of certain master planned communities in the Denver, Colorado metropolitan area. This development pattern was then applied to estimated future water tap fees calculated using historical water tap fees. Based on the weak new home construction market in the Denver metropolitan area, the Company updated its estimated discounted cash flow analysis as of February 28, 2009. There have been no significant changes in the assumptions since February 28, 2009, therefore, no change in the Tap Participation Fee was determined necessary after that date.

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 financial statements as well as its results of operations. An important component in the Company's estimate of the value of the Tap Participation Fee, 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 are thus partially indicative of the increasing value of the Company's water assets. The Company continues to assess the value of the Tap Participation Fee 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 the valuation of the Tap Participation Fee.

The Company imputes interest expense on the unpaid Tap Participation Fee using the effective interest method over the estimated development period utilized in the valuation of the liability. The Company imputed interest of approximately \$912,000 and \$2.7 million during the three and nine months ended May 31, 2010, respectively. The Company imputed interest of approximately \$858,000 and \$2.9 million during the three and nine months ended May 31, 2009, respectively.

After August 31, 2011, under circumstances defined in the Arkansas River Agreement, the Tap Participation Fee can increase to 20% of the Company's water tap fees and the number of water taps subject to the Tap Participation Fee would be correspondingly reduced by half. Payment of the Tap Participation Fee 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.

Revenue Recognition

The Company's revenue recognition policies have not changed since August 31, 2009, and are more fully described in Note 2 to the financial statements contained in the Company's 2009 Annual Report on Form 10-K.

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PURE CYCLE CORPORATION
NOTES TO FINANCIAL STATEMENTS
MAY 31, 2010

The Company recognized approximately \$3,600 and \$10,700 of water tap fee revenues during each of the three and nine months ended May 31, 2010 and 2009, respectively, related to the Water Service Agreement (the County Agreement) with Arapahoe County (the County) entered into in August 2005. The Company began recognizing the water tap fees as revenue ratably over the estimated service period upon completion of the Wholesale Facilities (defined in the Company's 2009 Annual Report on Form 10-K) in its fiscal 2006. The water tap fees to be recognized over this period are net of the royalty payments to the State of Colorado Board of Land Commissioners (the Land Board) and amounts paid to third parties pursuant to the Comprehensive Amendment Agreement No. 1 (the CAA) as further described in Note 5 below.

The Company recognized approximately \$10,400 and \$31,100 of Special Facilities (defined in the Company's 2009 Annual Report on Form 10-K) funding as revenue during each of the three and nine month periods ended May 31, 2010 and 2009, respectively. This is the ratable portion of the Special Facilities funding proceeds received from the County pursuant to the County Agreement as more fully described in Note 4 to the Company's financial statements contained in the Company's 2009 Annual Report on Form 10-K.

As of May 31, 2010, the Company has deferred recognition of approximately \$1.5 million of water tap and construction fee revenue from the County, which will be recognized as revenue ratably over the estimated useful accounting life of the assets constructed with the construction proceeds as described above.

Royalty and other obligations

Revenues from the sale of Export Water (which is defined in the Company's 2009 Annual Report on form 10-K) are shown net of royalties payable to the Land Board. Revenues from the sale of water on the Lowry Range Property are shown net of the royalties to the Land Board and the fees retained by the Rangeview Metropolitan District (the District).

Water and Wastewater Systems

If costs meet the Company's capitalization criteria, costs to construct water and wastewater systems are capitalized as incurred, including interest, and depreciated over the estimated useful lives of the water and wastewater systems. 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.

Depletion and Depreciation of Water Assets

The Company depletes its water assets that are being utilized on the basis of units produced divided by the total volume of water adjudicated in the water decrees. Water systems are depreciated on a straight line basis over their estimated useful lives of up to thirty years.

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. Because the Company has a full valuation allowance on its deferred tax assets, the granting and exercise of stock options has no impact on the income tax provisions.

The Company recognized approximately \$13,600 and \$55,900 of share-based compensation expenses during the three and nine months ended May 31, 2010, respectively. The Company recognized approximately \$64,900 and \$218,500 of share-based compensation expenses during the three and nine months ended May 31, 2009, respectively.

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PURE CYCLE CORPORATION
NOTES TO FINANCIAL STATEMENTS
MAY 31, 2010

Income taxes

The Company follows 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 or liabilities.

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 2006 through fiscal 2009. 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 May 31, 2010, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the three or nine months ended May 31, 2010 or 2009.

Recently Issued Accounting Pronouncements

The Company continually assesses new accounting pronouncements to determine their applicability to the Company. 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. New pronouncements assessed by the Company recently are discussed below:

In October 2009, the Financial Accounting Standards Board (FASB) issued a new accounting standard which provides guidance for arrangements with multiple deliverables. Specifically, the new standard requires an entity to allocate consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices. In the absence of the vendor-specific objective evidence or third-party evidence of the selling prices, consideration must be allocated to the deliverables based on management's best estimate of the selling prices. In addition, the new standard eliminates the use of the residual method of allocation. The standard will be effective for the Company for the fiscal year beginning September 1, 2010. Early adoption is permitted. The Company is currently evaluating the impact that the adoption of this standard may have on its financial statements.

In June 2009, the FASB issued the Accounting Standards Codification (the Codification) to become the single official source of authoritative, nongovernmental GAAP. The Codification did not change GAAP but reorganized the literature. The Company adopted the Codification standards effective September 1, 2009, which did not have a material effect on the Company's financial position, results of operations or cash flows.

In June 2009, the FASB issued new accounting and reporting standards to improve financial reporting by enterprises involved with variable interest entities and to address (1) the effects on certain provisions of consolidation of variable interest entities as a result of the elimination of the qualifying special-purpose entity concept and (2) constituent concerns about the application of certain key provisions including those in which the accounting and disclosures do not always provide timely and useful information about an enterprise's involvement in a variable interest entity. The new guidance is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009 (September 1, 2010 for the Company), for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. The Company is evaluating the impact the adoption of this guidance will have on its financial statements.

In December 2007, the FASB issued new accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, changes in a parent's ownership of a noncontrolling interest, calculation and disclosure of the consolidated net income attributable to the parent and the noncontrolling interest, changes in a parent's ownership interest while the parent retains its controlling financial interest and fair value measurement of any retained noncontrolling equity investment. The Company adopted the new standards effective September 1, 2009, which did not have a material effect on the Company's financial position, results of operations or cash flows.

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PURE CYCLE CORPORATION
NOTES TO FINANCIAL STATEMENTS
MAY 31, 2010

Reclassifications

Certain amounts in the May 31, 2009 financial statements have been reclassified to conform to the current presentation.

NOTE 2 FAIR VALUE MEASUREMENTS

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

Level 1 Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. The Company had none of these instruments at May 31, 2010.

Level 2 Valuations are obtained from readily available pricing sources via independent providers for market transactions involving similar assets or liabilities. The Company's principal market for these securities is the secondary institutional markets and valuations are based on observable market data in those markets. The Company had one Level 2 asset at May 31, 2010.

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 May 31, 2010, the Tap Participation Fee liability, which is described in greater detail in Note 1 above.

The Company maintains policies and procedures to value instruments using the best and most relevant data available. The Company applied the new accounting guidance issued by the FASB for all non-financial assets and liabilities measured at fair value on a non-recurring basis at September 1, 2009. The Company's non-financial assets measured at fair value on a non-recurring basis consists entirely of its investments in water and water systems and other long-lived assets. Since the Company performed its annual impairment analyses of its long-lived assets as of August 31, 2009, (with no indicators of impairment) and since no impairment trigger event occurred during the first three quarters of fiscal 2010, the adoption of the new FASB standard for non-financial assets and liabilities measured at fair value on a non-recurring basis did not have an impact on the Company's financial position, results of operations or cash flows.

Level 2 Asset Marketable Securities Measured on a Recurring Basis

The Company's marketable securities are the Company's only financial assets measured on a recurring basis. The fair values of the marketable securities are based on the values reported by the financial institutions where the funds are held. These securities include only federally insured certificates of deposit.

Level 3 Liability Tap Participation Fee Payable to HP A&M

The Company's Tap Participation Fee liability is the Company's only financial liability measured on a non-recurring basis. As further described in Note 1 above, the Tap Participation Fee liability is valued by projecting new home development in the Company's targeted service area over an estimated development period.

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PURE CYCLE CORPORATION
NOTES TO FINANCIAL STATEMENTS
MAY 31, 2010

The following table provides information on the assets and liabilities measured at fair value as of May 31, 2010:

	Carrying Value	Fair Value	Fair Value Measurement Using:			
			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
Marketable securities	\$ 2,022,600	\$ 2,022,600	\$	\$ 2,022,600	\$	\$
Tap Participation Fee liability	\$ 60,215,300	\$ 60,215,300	\$	\$	\$ 60,215,300	\$

Although not required, the Company deems the following table, which presents the changes in the Tap Participation Fee for the nine months ended May 31, 2010, to be helpful to the users of its financial statements:

	Fair Value Measurement using Significant Unobservable Inputs (Level 3)		
	Gross Estimated Tap Participation Fee Liability	Tap Participation Fee Reported Liability	Discount to be imputed as interest expense in future periods
Balance at August 31, 2009	\$ 113,147,700	\$ 57,521,300	\$ 55,626,400
Total gains and losses (realized and unrealized):			
Imputed interest recorded as Other Expense		2,694,000	(2,694,000)
Increase in estimated value (to be realized in future periods)			
Purchases, sales, issuances, payments, and settlements			
Transfers in and/or out of Level 3			
Balance at May 31, 2010	\$ 113,147,700	\$ 60,215,300	\$ 52,932,400

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.

Notes Receivable and Construction Proceeds Receivable: The carrying amounts of the Company's notes receivable and construction proceeds receivable approximate fair value as they bear interest at rates which are comparable to current market rates.

Off-Balance Sheet Instruments: The Company's off-balance sheet instruments consist entirely of the contingent portion of the CAA (described further in Note 5 below). Because repayment of this portion of the CAA is contingent on the sale of Export Water, the Company has determined that the contingent portion of the CAA does not have a determinable fair value.

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PURE CYCLE CORPORATION
NOTES TO FINANCIAL STATEMENTS
MAY 31, 2010

NOTE 3 INVESTMENTS IN WATER AND WATER SYSTEMS

The Company's investments in water and water systems consist of the following:

	May 31, 2010 (unaudited)		August 31, 2009	
	Costs	Accumulated Depreciation and Depletion	Costs	Accumulated Depreciation and Depletion
Arkansas River Valley assets	\$ 81,240,832	\$ (1,034,069)	\$ 81,241,428	\$ (823,660)
Rangeview water supply	14,285,718	(5,753)	14,271,786	(5,544)
Rangeview water system	167,720	(55,873)	167,720	(51,978)
Paradise water supply	5,536,420		5,532,619	
Fairgrounds water and water system	2,899,863	(336,366)	2,899,863	(270,317)
Sky Ranch water supply	100,000		100,000	
LAWMA Shares	77,940		77,940	
Water supply other	25,629	(7,652)	23,713	(3,938)
Totals	104,334,122	(1,439,713)	104,315,069	(1,155,437)
Net investments in water and water systems	\$ 102,894,409		\$ 103,159,632	

The Company's water rights and current water and wastewater service agreements are more fully described in Note 4 to the financial statements contained in the Company's 2009 Annual Report on Form 10-K. There have been no significant changes to the Company's water rights or water and wastewater service agreements during the three or nine months ended May 31, 2010.

Depletion and Depreciation

The Company recorded less than \$100 and approximately \$200 of depletion charges during the three and nine month periods ended May 31, 2010, respectively. The Company recorded less than \$100 and approximately \$300 of depletion charges during the three and nine month periods ended May 31, 2009, respectively. This related entirely to the use of the Rangeview Water Supply. No depletion is taken against the Arkansas River water, the Paradise Water Supply or Sky Ranch Water Supply because these assets have not been placed into service as of May 31, 2010.

The Company recorded approximately \$96,600 and \$289,900 of depreciation expense during the three and nine months ended May 31, 2010, respectively. The Company recorded approximately \$95,300 and \$284,900 of depreciation expense during the three and nine months ended May 31, 2009, respectively.

Land sales

On February 10, 2010, the Company sold approximately four acres of farm land in the Arkansas River Valley in Southern Colorado for \$10,000 (\$2,500 per acre) in cash. The land had an allocated carrying value of approximately \$600, which resulted in a gain of approximately \$9,400 being recorded during the nine months ended May 31, 2010. The Company maintained all water rights associated with the acreage that was sold.

During the three months ended May 31, 2009, the Company sold approximately 210 acres of non-irrigated land for approximately \$37,500 in cash (net of approximately \$2,200 of fees). Because the Company assigned no value to the non-irrigated land at the acquisition date (the land was deemed to have a fair value of zero at the acquisition date), the proceeds to the Company are recorded as a gain on sale of land in the accompanying statement of operations in 2009. Pursuant to the Arkansas River Agreement, 100% of the proceeds from the sale of the non-irrigated land are required to be paid to HP A&M, which resulted in credits to the Tap Participation Fee equivalent to the sale of 18 water taps.

There are 38,937 water taps remaining subject to the Tap Participation Fee as of May 31, 2010.

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PURE CYCLE CORPORATION
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 MAY 31, 2010

NOTE 4 HP A&M PROMISSORY NOTES

Certain of the properties the Company acquired from HP A&M are subject to outstanding promissory notes with principal and accrued interest totaling approximately \$11.5 million at May 31, 2010 and \$12.0 million at August 31, 2009. Additional information regarding these promissory notes, the circumstances under which the Company would be required to make payments pursuant to these notes and the accounting treatment of these notes is more fully described in Note 8 to the financial statements contained in the Company's 2009 Annual Report on Form 10-K.

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 approximately \$11.1 million, which represents the cash the Company received and used to purchase its Export Water. In return, 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. 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 sales 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 approximately 35% of the original total liability of \$31.8 million, 35% of each payment remitted to the CAA holders is allocated to the recorded liability account. The remaining portion of each payment, approximately 65%, is allocated to the contingent obligation, which is recorded on a net revenue basis.

As a result of the CAA acquisitions, and sales of Export Water, as detailed in the table below, the total remaining potential third party obligation as of May 31, 2010 is approximately \$3.5 million:

	Export Water Proceeds Received	Initial Export Water Proceeds to Pure Cycle	Total Potential Third party Obligation	Participating Interests Liability	Contingency
Original balances	\$	\$ 218,500	\$ 31,807,732	\$ 11,090,630	\$ 20,717,102
<i>Activity from inception until August 31, 2009:</i>					
Acquisitions		28,077,500	(28,077,500)	(9,789,983)	(18,287,517)
Option payments Sky Ranch and The Hills at Sky Ranch	110,400	(42,280)	(68,120)	(23,754)	(44,366)
Arapahoe County tap fees *	532,968	(373,078)	(159,890)	(55,754)	(104,136)
Export Water sale payments	45,662	(31,964)	(13,699)	(4,779)	(8,920)
Balance at August 31, 2009	689,030	27,848,678	3,488,523	1,216,360	2,272,163
<i>Fiscal 2010 activity (unaudited):</i>					
Export Water sale payments	9,406	(6,584)	(2,822)	(984)	(1,838)

Balance at May 31, 2010	\$ 698,436	\$ 27,842,094	\$ 3,485,701	\$ 1,215,376	\$ 2,270,325
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* The Arapahoe County tap fees are less a \$34,522 royalty payment 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 three payees receive their full payment before the next priority level receives any payment and so on until full repayment. The Company will receive approximately \$5.1 million of the first priority payout (the entire first priority payout totals approximately \$7.3 million as of May 31, 2010).

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PURE CYCLE CORPORATION
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MAY 31, 2010

NOTE 6 SHAREHOLDERS EQUITY

The Company maintains the 2004 Incentive Plan (the Equity Plan), which was approved by stockholders in April 2004. Executives, eligible employees and non-employee directors are eligible to receive options and restricted stock grants pursuant to the Equity Plan. Pursuant to the Equity Plan, options to purchase shares of stock and restricted stock awards can be granted with exercise prices and vesting periods determined by the Compensation Committee of the Board. The Company initially reserved 1.6 million shares of common stock for issuance under the Equity Plan. As of May 31, 2010, the Company has 1,303,311 common shares that can be granted to eligible participants pursuant to the Equity Plan.

The Company is required to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model and to expense the fair value over the vesting period of the grant. For additional information on the Equity Plan, including a summary of the significant assumptions, refer to the Company's Form 10-K for the year ended August 31, 2009.

The following table summarizes stock option activity for the Equity Plan for the nine months ended May 31, 2010:

	Number of Options	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term	Approximate Aggregate Intrinsic Value
Outstanding at beginning of period	250,000	\$ 6.43		
Granted	12,500	2.88		
Exercised				
Forfeited or expired				
Outstanding at May 31, 2010	262,500	\$ 6.26	7.0	*
Options exercisable at May 31, 2010	186,000	\$ 7.57	6.0	*

* Intrinsic value less than zero.

The following table summarizes the activity and value of non-vested options as of and for the nine months ended May 31, 2010:

	Number of Options	Weighted- Average Grant Date Fair Value
Non-vested options outstanding at beginning of period	79,000	\$ 2.66
Granted	12,500	2.68
Vested	(15,000)	2.42
Forfeited		
Non-vested options outstanding at May 31, 2010	76,500	\$ 2.71

The total fair value of options vested during both the three and nine month periods ended May 31, 2010, was approximately \$36,300. The total fair value of options vested during both the three and nine month periods ended May 31, 2009, was approximately \$93,700.

Stock-based compensation expense for the three months ended May 31, 2010 and 2009, was approximately \$13,600 and \$64,900, respectively. Stock-based compensation expense for the nine months ended May 31, 2010 and 2009, was approximately \$55,900 and \$218,500, respectively.

At May 31, 2010, the Company has unrecognized expenses relating to non-vested options that are expected to vest totaling approximately \$162,000. The weighted-average period over which these options are expected to vest is approximately three years. The Company has not recorded any excess tax benefits to additional paid in capital.

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There were no options exercised during the three or nine months ended May 31, 2010 or 2009.

In January 2010, the Company granted its directors options to purchase a combined 12,500 shares of the Company's common stock pursuant to the 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 approximately \$31,200 using the Black-Scholes model with the following variables: weighted average exercise price of \$2.88 (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 3.74%; weighted average stock price volatility of 88.4%; and an estimated forfeiture rate of 0%. The \$31,200 of stock-based compensation is being expensed monthly over the vesting period.

In January 2009, the Company granted its directors options to purchase a combined 15,000 shares of the Company's common stock pursuant to the 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 approximately \$36,300 using the Black-Scholes model with the following variables: weighted average exercise price of \$2.94 (which was the closing sales price of the Company's common stock on the date of the grant); estimated option lives of eight years; estimated dividend rate of 0%; weighted average risk-free interest rate of 2.33%; weighted average stock price volatility of 91.6%; and an estimated forfeiture rate of 0%. The \$36,300 of stock-based compensation is being expensed monthly over the vesting period.

Comprehensive Loss. In addition to net loss, comprehensive loss includes the unrecognized changes in the fair value of marketable securities that are classified as available-for-sale as noted in the following table:

	Three Months Ended		Nine Months Ended	
	May 31, 2010	May 31, 2009	May 31, 2010	May 31, 2009
Net loss	\$ (1,333,400)	\$ (1,325,200)	\$ (4,126,400)	\$ (4,438,500)
Unrealized gain (loss) on marketable securities	200	3,600	(3,800)	3,600
Comprehensive loss	\$ (1,333,200)	\$ (1,321,600)	\$ (4,130,200)	\$ (4,434,900)

NOTE 7 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). During the three and nine months ended May 31, 2010, the Company provided funding of approximately \$92,100, which was the initial membership fees required for the District to join SMWSA. We anticipate providing additional funding of approximately \$20,000 per year to maintain the District's membership in SMWSA. The \$92,100 funding was expensed in the general and administrative line in the accompanying statement of operations.

In 1995, the Company extended a loan to the District. 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 May 31, 2010) and matures on December 31, 2010. The approximately \$516,800 balance of the note receivable at May 31, 2010 includes principal borrowings of approximately \$229,300 and accrued interest of approximately \$287,500. Because the Company does not expect to collect this loan before the December 31, 2010 maturity date, and it intends to extend the maturity date for one year, the receivable from the District is recorded as a non-current asset at May 31, 2010. The approximately \$507,800 balance of the note receivable at August 31, 2009 includes principal borrowings of approximately \$229,300 and accrued interest of approximately \$278,500.

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PURE CYCLE CORPORATION
NOTES TO FINANCIAL STATEMENTS
MAY 31, 2010

NOTE 8 SIGNIFICANT CUSTOMERS

The Company had accounts receivable from customers totaling the following approximate amounts:

	As of May 31, 2010 (unaudited)		As of August 31, 2009	
	Receivable Balance	% of Total Accounts Receivable	Receivable Balance	% of Total Accounts Receivable
Ridgeview Youth Services Center	\$ 45,100	81%	\$ 51,800	82%
County	2,100	4%	3,800	6%
Schmidt Aggregates	5,600	10%	4,700	7%
Combined	\$ 52,800	95%	\$ 60,300	95%

The Company earned water and wastewater revenues from two customers totaling the following approximate amounts (amounts are unaudited):

	Three Months Ended May 31, 2010		2009	
	Revenues	% of Total Revenues	Revenues	% of Total Revenues
Ridgeview Youth Services Center	\$ 33,600	58%	\$ 38,900	62%
County	3,100	5%	3,300	5%
Combined	\$ 36,700	63%	\$ 42,200	67%

	Nine Months Ended May 31, 2010		2009	
	Revenues	% of Total Revenues	Revenues	% of Total Revenues
Ridgeview Youth Services Center	\$ 105,900	63%	\$ 113,700	63%
County	8,900	5%	9,300	5%
Combined	\$ 114,800	68%	\$ 123,000	68%

NOTE 9 SUPPLEMENTAL DISCLOSURES OF NON-CASH ACTIVITIES

	Nine months ended May 31,	
	2010	2009
Increase in estimated Tap Participation Fee liability and related discount	\$	\$ 4,714,387

NOTE 10 SUBSEQUENT EVENTS

We evaluated events that occurred subsequent to May 31, 2010, for recognition or disclosure in the financial statements and notes to the financial statements.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Disclosure Regarding Forward-Looking Statements

Certain statements in this Quarterly Report, including estimates, projections, forecasts, and assumptions, but excluding purely historical information, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The words anticipate, believe, estimate, expect, plan, intend, would and similar expressions 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. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, without limitation, the timing of development of the areas where we may sell our water, including uncertainties related to the real estate market generally and the development of projects the Company currently has under contract, the market price of water, changes in customer consumption patterns, changes in applicable statutory and regulatory requirements, uncertainties in the estimation of water available under decrees, costs of delivery of water and treatment of wastewater, 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, labor relations, availability and cost of material and equipment, delays in anticipated permit and construction dates, environmental risks, the results of financing efforts and the ability to meet capital requirements, and general economic conditions. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

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;
- Expenses associated with developing our water assets; and
- Cash available to continue development of our water rights and service agreements.

The following Management's Discussion and Analysis (MD&A) is intended to help the reader understand our results of operations and financial condition and should be read in conjunction with the accompanying financial statements and the notes thereto and the financial statements and the notes thereto contained in our 2009 Annual Report on Form 10-K. This overview summarizes the MD&A, which includes the following sections:

- Our Business a general description of our business, our services and our business strategy.
- Results of Operations an analysis of our results of operations for the periods presented in our 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.
- Critical Accounting Policies and Estimates a discussion of our critical accounting policies that require critical judgments, assumptions and estimates.

Table of Contents**Our Business**

Pure Cycle Corporation is a water and wastewater service provider engaged in the design, construction, operation and maintenance of water and wastewater systems. We contract with land owners, land developers, home builders, cities, and municipalities to design, construct, operate and maintain water and wastewater systems using our water portfolio, which includes surface water and groundwater supplies, surface water storage, alluvial aquifer storage, and reclaimed water supplies. We generate cash flows and revenues primarily from (i) water and wastewater tap (connection) charges and (ii) monthly service fees and consumption charges. Water and wastewater tap fee charges are one-time fees paid by developers or other customers for the right to obtain service from us. A portion of the tap fee revenue is used by us to construct various facilities to withdraw, store, treat, and distribute potable water; to collect and treat wastewater and to store, treat, and distribute reclaimed and raw water for irrigation and other non-potable uses. Monthly water service fees, consumption charges (based on metered deliveries of potable water and irrigation water, which are billed at different rates), flat monthly wastewater service fees, and other service related fees are paid by our customers (e.g., homeowners, businesses, institutional facilities, etc.). We currently provide water services to approximately 247 single-family-equivalent water connections and 157 single-family-equivalent wastewater connections located in the southeastern Denver metropolitan area. We also provide contract operating services to other water providers, land owners, etc., where we manage specific functions of their water and/or wastewater systems. We have a vertically integrated business model which provides us with control and efficiency in the provision of water and wastewater services by owning all components necessary to offer complete water and wastewater services. Having a vertically integrated system means we own all assets required to provide water and wastewater services, including the following:

- Water rights used to provide domestic and irrigation water to customers;
- Infrastructure required to withdraw, treat, store and deliver domestic water to customers;
- Infrastructure required to collect, treat, store and reuse wastewater; and
- Infrastructure required to treat and deliver reclaimed water for irrigation customers.

We did not sell any water taps or wastewater taps during the three or nine months ended May 31, 2010 and 2009. We received approximately \$27,300 and \$76,700 from the sale of water during the three and nine months ended May 31, 2010, respectively. We received approximately \$31,800 and \$88,400 from the sale of water during the three and nine months ended May 31, 2009, respectively. We received approximately \$16,700 and \$50,200 from monthly wastewater service fees during each of the three and nine month periods ended May 31, 2010 and 2009, respectively. Currently all monthly water and wastewater fees are generated utilizing our Rangeview Water Supply (defined in our 2009 Annual Report on Form 10-K). See Critical Accounting Policies below regarding our revenue recognition policies for tap fees and construction fees.

Results of Operations*Executive Summary*

The results of our operations for the three months ended May 31, 2010 and 2009 are as follows:

Summary Table 1**Three Months Ended May 31:**

	2010	2009	Change	% Change
Millions of gallons of water delivered	5.6	7.6	(2.0)	-26%
Water revenues generated	\$ 27,300	\$ 31,800	\$ (4,500)	-14%
Operating costs to deliver water (excluding depreciation and depletion)	\$ 7,800	\$ 10,200	\$ (2,400)	-24%
Water delivery gross margin %	71%	68%		
Wastewater treatment revenues	\$ 16,700	\$ 16,700	\$	0%
Operating costs to treat wastewater	\$ 5,800	\$ 4,500	\$ 1,300	29%
Wastewater treatment gross margin %	65%	73%		

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General and administrative expenses	\$ 387,300	\$ 455,500	\$ (68,200)	-15%
Net losses	\$ 1,333,400	\$ 1,325,200	\$ 8,200	1%

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Summary Table 2
Nine Months Ended May 31,

	2010	2009	Change	% Change
Millions of gallons of water delivered	13.7	19.2	(5.5)	-29%
Water revenues generated	\$ 76,700	\$ 88,400	\$ (11,700)	-13%
Operating costs to deliver water (excluding depreciation and depletion)	\$ 33,200	\$ 38,000	\$ (4,800)	-13%
Water delivery gross margin %	57%	57%		
Wastewater treatment revenues	\$ 50,200	\$ 50,200	\$	0%
Operating costs to treat wastewater	\$ 16,200	\$ 16,100	\$ 100	1%
Wastewater treatment gross margin %	68%	68%		
General and administrative expenses	\$ 1,327,500	\$ 1,547,900	\$ (220,400)	-14%
Net losses	\$ 4,126,400	\$ 4,438,500	\$ (312,100)	-7%

Water and Wastewater Usage Revenues

Our water service charges include a base monthly fee and a usage fee which is based on a tiered pricing structure that provides for higher prices as customers use greater amounts of water. Our rates and charges are established based on the average of three surrounding water providers.

Our wastewater customers are charged flat monthly fees based on their number of tap connections.

Comparison of usage fees and gross margins

Water deliveries for the three and nine months ended May 31, 2010, decreased 26% and 29%, respectively, over the comparable periods in 2009. This was mainly attributable to decreased water usage at our largest customer due to a reduction in funding experienced by the customer as a result of the economy, which resulted in the closing of student housing facilities resulting in reduced water usage. As a result, water usage revenues decreased 14% and 13% for the three and nine months ended May 31, 2010 over the comparable periods in 2009, respectfully. The percentage decreases were less than the water usage percentage decrease due to rate increases at July 1, 2009.

Despite the decreased water usage and therefore decreased water usage revenue, our gross margins remained consistent period over period, and even increased slightly during the three months ended May 31, 2010 compared to 2009. This is because we were able to reduce certain costs commensurate with the reductions in water deliveries.

Wastewater revenues remain unchanged from 2009 to 2010. The wastewater operating gross margin percentage for the three months ended May 31, 2010 decreased approximately 8% over the comparable period in 2009, and the wastewater operating gross margin percentage was unchanged for the nine months ended May 31, 2010 compared to the nine months ended May 31, 2009. The wastewater margin decrease was due to higher energy costs and testing costs at our wastewater facility.

Tap Fees

We recognized approximately \$3,600 and \$10,700 of water tap fee revenues during each of the three and nine month periods ended May 31, 2010 and 2009, respectively, related to the Agreement for Water Service (the County Agreement) with Arapahoe County (the County). In accordance with accounting principles generally accepted in the United States of America (GAAP), we began recognizing the water tap fees as revenue ratably over the estimated service period upon completion of the Wholesale Facilities in fiscal 2006. The water tap fees to be recognized over this period are net of the royalty payments to the State Board of Land Commissioners (the Land Board) and amounts paid to third parties pursuant to the Comprehensive Amendment Agreement No. 1 (the CAA) as further described in Note 5 to the accompanying financial statements.

We recognized approximately \$10,400 and \$31,100 of Special Facilities funding as revenue during each of the three and nine month periods ended May 31, 2010 and 2009, respectively. This is the ratable portion of the Special

Facilities funding proceeds received from the County pursuant to the County Agreement as more fully described in Note 4 to the financial statements contained in our 2009 Annual Report on Form 10-K.

As of May 31, 2010, we have deferred recognition of approximately \$1.5 million of water tap and construction fee revenue from the County, which will be recognized as revenue ratably over the estimated useful accounting life of the assets constructed with the construction proceeds as described above.

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General and Administrative Expenses

General and administrative expenses for the three and nine months ended May 31, 2010 increased approximately 15% and decreased approximately 14%, respectively, over the comparable periods in 2009. Our general and administrative expenses for the three and nine months ended May 31, 2010 and 2009, respectively, are comprised of approximately:

Salary and related expenses:

Including share-based compensation expenses:

Were \$147,300 and \$440,600, for the three and nine months ended May 31, 2010, respectively, and were \$189,800 and \$588,400 for the three and nine months ended May 31, 2009, respectively. The decreases were mainly a result of the reduced share-based compensation expense due to the lower stock price resulting in a lower fair value per option share and more options being expensed in the prior year than in the current year.

Excluding share-based compensation expenses:

Were \$133,700 and \$384,700, for the three and nine months ended May 31, 2010, respectively, and were \$124,900 and \$369,800, for the three and nine months ended May 31, 2009, respectively. The increases in the salary and related expenses excluding share-based compensation expenses was mainly due to us recording 50% of the salary of a farm manager in the Arkansas Valley this year starting January 1, 2010 in our salary and wages accounts. These expenses were included in a separate line item in the 2009 general and administrative expenses.

During the nine months ended May 31, 2010, we, along with the District, paid approximately \$92,100 to join the South Metro Water Supply Authority (SMWSA). Per the SMWSA 's website, SMWSA is the region 's leader in the development of innovative water supply and infrastructure projects. SMWSA is an experienced and knowledgeable entity that plans, develops and sources renewable water for Douglas and Arapahoe Counties in Colorado. The organization is comprised of 14 individual water providers that work collaboratively to foster long-term reliable water supplies through water acquisition and infrastructure development.

Fort Lyon Canal Company (FLCC) water assessment fees were \$83,800 and \$271,400, for the three and nine months ended May 31, 2010, respectively, and were \$83,900 and \$258,100, for the three and nine months ended May 31, 2009, respectively. The increase in the nine months ended expense is a result of increased 2010 calendar year assessments. In December 2009, the FLCC shareholders approved a \$1.00 per share increase in the fees which will result in an increase of our fees of approximately \$21,600 per year. The calendar 2010 FLCC fee is \$15.50 per share.

Professional fees were \$58,300 and \$144,300, for the three and nine months ended May 31, 2010, respectively, and were \$80,400 and \$272,700, for the three and nine months ended May 31, 2009, respectively. The reductions in professional fees was due to our cost reduction efforts in light of the withdrawal of the developer from the Lowry Range in January 2009, which has delayed development at the Lowry Range.

Consulting fees were \$15,000 and \$42,500, for the three and nine months ended May 31, 2010, respectively, and were \$12,400 and \$74,800, for the three and nine months ended May 31, 2009, respectively. Consulting fees were reduced for the same reasons as professional fees were reduced.

Table of Contents*Other Income and Expenses*

Interest income totaled approximately \$18,200 and \$55,400 for the three and nine months ended May 31, 2010, respectively. Interest income totaled approximately \$12,900 and \$70,500 for the three and nine months ended May 31, 2009, respectively. This represents interest earned on the temporary investment of capital, interest accrued on our notes receivable from related parties and interest accrued on the construction proceeds receivable from Arapahoe County. The decrease is due to the continued decline in interest rates both on our invested capital and for the notes receivable from related parties as well as reductions in invested capital due to the use of capital for operations. Our temporary investments were invested in overnight money market funds related to treasury obligations until March 2009 when we transferred approximately \$3.0 million into federally insured certificates of deposit with scheduled maturities and set interest rates which are not subject to market risk. Our certificates of deposit are held by various financial institutions in amounts less than federally insured limits.

The imputed interest expense is related to the Tap Participation Fee payable to High Plains A&M, LLC (HP A&M) (as defined in the *Liquidity and Capital Resources* section below). This represents the expensed portion of the difference between the estimated fair value of the liability and the net present value of the liability recognized under the effective interest method. For the three and nine months ended May 31, 2010, we imputed interest on the Tap Participation Fee of approximately \$912,000 and \$2.7 million, respectively. For the three and nine months ended May 31, 2009, we imputed interest on the Tap Participation Fee of approximately \$858,000 and \$2.9 million, respectively. See also Note 1 to the accompanying financial statements for discussion on the revaluation of the Tap Participation Fee in fiscal 2009.

Net losses for the three months ended May 31, 2010 increased approximately 1% over the comparable period in 2009. The increase is attributable mainly to the increased imputed interest on the Tap Participation Fee, which was offset by our cost cutting efforts noted above. Net losses for the nine months ended May 31, 2010 decreased approximately 7% over the comparable period in 2009. This is due mainly to our cost cutting measures this year as detailed in the general and administrative expense fluctuation analysis above, offset by the payment of approximately \$92,100 to join SMWSA as described above.

Liquidity and Capital Resources

At May 31, 2010, our working capital, defined as current assets less current liabilities, was approximately \$2.7 million, approximately \$2.5 million of which consisted of cash and cash equivalents and certificates of deposit. We also have an effective shelf registration statement pursuant to which we may elect to sell up to another \$5.7 million of stock at any time and from time to time. We believe that at May 31, 2010, we have sufficient working capital to fund our operations for the next fiscal year. However, there can be no assurance that we will be successful in marketing the water from our primary water projects in the near term. In order to generate working capital to support our operations, we may incur additional short or long-term debt or seek to sell additional equity securities.

Development of the water that we own, have rights to use, or may seek to acquire, will require substantial capital investments. We anticipate that capital required for the development of the water and wastewater systems will be financed through the sale of water taps to developers. A water tap fee refers to a charge we impose to fund construction of Wholesale Facilities (Wholesale Facilities are further defined in our 2009 Annual Report on Form 10-K) and permit access to our water delivery system. We anticipate tap fees will be sufficient to generate funds with which we can design and construct the necessary Wholesale Facilities. However, once we receive tap fees from a developer, we are contractually obligated to construct the Wholesale Facilities for the taps paid for, even if our costs are not covered by the fees we receive. We cannot assure you that these sources of cash will be sufficient to cover all our capital costs, in which case we would need to seek additional financing.

On a monthly basis, water customers are charged a flat base fee and usage fees, generally charged per 1,000 gallons of water delivered to the customer, and wastewater customers are charged flat monthly service fees. These fees are used to fund on-going operational expenses, including general and administrative expenses.

As further described in our 2009 Annual Report on Form 10-K, *Critical Accounting Policies* below and Note 1 to the accompanying financial statements, pursuant to the Arkansas River Agreement we agreed to pay HP A&M 10% of our water tap fees received on the sale of the next 40,000 water taps we sell from and after the date of the Arkansas River Agreement (the Tap Participation Fee). As of May 31, 2010, we have estimated the value of the Tap Participation Fee payable to HP A&M at approximately \$113.1 million. The balance reflected on the accompanying

balance sheet of approximately \$59.3 million excludes the discount of \$60.2 million based on a discounted cash flow valuation analysis, which was originally prepared at August 31, 2006, and was updated as of February 28, 2009 (no update was deemed necessary at May 31, 2010). See Note 1 in the accompanying financial statements for further discussion of the revaluation. The actual amount to be paid will inevitably be different from our estimates. Tap participation payments are not payable to HP A&M until we receive water tap fee payments. We did not sell any taps and did not make any Tap Participation Fee payments during the three or nine months ended May 31, 2010. There remain 38,937 taps subject to the Tap Participation Fee as of May 31, 2010.

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We are obligated to pay annual water assessment charges to various canal systems for the upkeep and maintenance of the agricultural delivery canals for our Arkansas River water. These water assessment charges are assessed on all shareholders of the canal systems on a pro-rata basis. The majority of our water assessment charges are paid to the FLCC and are due in three installment payments each calendar year. In December 2009, the board of the FLCC approved an increase to the calendar 2010 assessments from \$14.50 per share to \$15.50 per share, which equates to an increase in our water assessments from approximately \$314,000 per year to approximately \$335,000 per year.

Operating Activities

Operating activities include revenues we receive from the provision of water and wastewater services to our customers, costs incurred in the delivery of those services, general and administrative expenses, and depletion/depreciation expenses.

Cash used by operating activities was approximately \$1.2 million for both nine month periods ended May 31, 2010 and 2009, respectively, which is consistent period over period.

We incurred approximately \$291,400 and \$286,100 of depreciation, depletion and other non-cash charges during the nine months ended May 31, 2010 and 2009, respectively, which is a change of less than 2%.

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

Investing Activities

We continue to invest in legal and engineering fees associated with our water rights, and we continue to invest in the right-of-way permit fees to the Department of Interior Bureau of Land Management and legal and engineering costs for our Paradise Water Supply.

Investing activities provided approximately \$956,200 during the nine months ended May 31, 2010, predominately from the sale of marketable securities which totaled \$975,800 which was offset by investments in water systems of approximately \$19,600. Investing activities used approximately \$3.1 million during the nine months ended May 31, 2009, predominately for the purchase of marketable securities (\$3.0 million) and investments in water supplies and systems (\$110,400).

Financing Activities

Financing activities provided approximately \$59,400 during the nine months ended May 31, 2010, predominately due to approximately \$61,600 of construction proceed payments received from Arapahoe County, which were partially offset by payments to the CAA holders. Financing activities provided approximately \$22,200 during the nine months ended May 31, 2009, predominately due to approximately \$61,600 of construction proceed payments received from Arapahoe County, which were partially offset by the approximately \$37,500 Tap Participation Fee payments made to HP A&M related to the sale of the non-irrigated land.

Off-Balance Sheet Arrangements

Our off-balance sheet arrangements consist entirely of the CAA, which is more fully described in Note 5 to the financial statements contained in our 2009 Annual Report on Form 10-K, and in Note 5 to the accompanying financial statements.

Recently Issued and Recently Adopted Accounting Pronouncements

See Note 1 to the accompanying financial statements regarding recently issued and recently adopted accounting pronouncements.

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Critical Accounting Policies

The preparation of financial statements in conformity with 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 analysis of our water rights, management's valuation of the Tap Participation Fee, and stock-based compensation. Below is a summary of these critical accounting policies.

Revenue Recognition

Our revenues consist mainly of tap fees and monthly service fees. As further described in Note 2 to the financial statements in our 2009 Annual Report on Form 10-K, proceeds from tap sales are deferred upon receipt and recognized in income based on whether we own or do not own the facilities constructed with the proceeds. When we construct infrastructure to be owned by the customer, we recognize tap fee revenue 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 three and nine months ended May 31, 2010 or 2009.

Tap fees derived from agreements under 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 be matched with the revenues.

Impairment of Water Assets and Other Long-Lived Assets

We review our long-lived assets for impairment at least annually or 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 will encompass many housing and economic cycles. Our service capacities are quantitatively estimated based on an average single family home utilizing .4 acre-feet of water per year. Our water supplies are legally decreed to us through the Colorado Water Court. The Colorado 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 or the amount of water legally decreed to us.

We report assets to be disposed of at the lower of the carrying amount or fair value less costs to sell. There were no assets to be disposed of at May 31, 2010.

Table of Contents**Our Front Range and Arkansas River Water Rights**

We determine the undiscounted cash flows for our Denver based assets and the Arkansas River Valley 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, 2009, and determined that our Rangeview and Arkansas River water assets were not impaired and their costs were 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. We estimate that we have the ability to provide water services to approximately 180,000 SFE s using our combined Front Range and Arkansas River water assets which have a carrying value of approximately \$97.4 million as of May 31, 2010. Based on the carrying value of our water rights, the long term and uncertain nature of any development plans, current tap fees of \$22,500 and estimated gross margins, we estimate that we would need to add approximately 8,000 new water connections (requiring approximately 4.8% of our portfolio) to generate net revenues sufficient to recover the costs of our Front Range and Arkansas River water assets. If tap fees increase 5%, we would need to add approximately 7,600 new water taps (requiring approximately 4.6% of our portfolio) to recover the costs of our Front Range and Arkansas River water assets. If tap fees decrease 5%, we would need to add approximately 8,400 new water taps (requiring approximately 5.0% of our portfolio) to recover the costs of our Front Range and Arkansas River water assets.

Although the withdrawal of the Lowry Range developer, the Sky Ranch bankruptcy filing, and changes in the housing market throughout the Front Range have delayed our estimated tap sale projections, they do not alter our water ownership, our service obligation to these properties or the number of SFE s we can service.

Our Paradise Water Rights

Every six years the Paradise Water Supply is subject to a Finding of Reasonable Diligence review by the Colorado Water Court and the State Engineer. For a favorable finding, the Colorado Water Court must determine that we continue to diligently pursue the development of the water rights. If the Colorado Water Court does not make such a finding, our right to the Paradise Water Supply would be lost and we would be required to impair the Paradise Water Supply asset. The most recent diligence review was started in our fiscal 2005 and was completed in 2008, but not without objectors and not without us having to agree to certain stipulations to remove the objections. In order to continue to maintain the Paradise water right, over the next six years we must (i) select an alternative reservoir site; (ii) file an application in Colorado Water Court to change the place of storage; (iii) identify specific end users and place(s) of use of the water; and (iv) identify specific source(s) of the water rights for use. We fully intend to meet the stipulations by the date of the next diligence review in 2014.

For our Paradise Water Supply, we determined the undiscounted cash flows by estimating the proceeds we could derive from the leasing of the water rights to commercial, industrial, and agricultural users along the western slope of Colorado. Based on the impairment analysis we completed at August 31, 2009, we believe the Paradise Water Supply is not impaired and the costs are deemed recoverable.

Tap Participation Fee

On August 31, 2006, we acquired 60,000 acre-feet of Arkansas River water along with approximately 17,500 acres of real property and other associated rights from HP A&M. Along with common stock issued to HP A&M, we agreed to pay HP A&M 10% (this may increase to 20% under circumstances described in Note 8 to the 2009 Annual Report on Form 10-K) of our tap fees on the sale of the next 40,000 water taps we sell from and after the date of the Arkansas River Agreement, of which 38,937 water taps remain to be paid as of May 31, 2010. 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 in the HP A&M acquisition. The Tap Participation Fee 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 estimated future water tap fees determined by using historical water tap fee trends. Based on updated new home activity in the Denver metropolitan area, we updated the estimated discounted cash flow analysis as of February 28, 2009. Due to a lack of significant changes, no such update was deemed necessary as of May 31, 2010. 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. An important component in our estimate of the value of the Tap Participation Fee, which is based on historical trends, is that we reasonably expect 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 are thus partially indicative of the increasing value of our water assets. We continue to assess the value of the Tap Participation Fee liability and update 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 the valuation of the Tap Participation Fee.

Table of Contents*Obligations Payable by HP A&M*

Certain of the properties we acquired pursuant to the Arkansas River Agreement are subject to outstanding promissory notes with principal and accrued interest totaling approximately \$11.5 million at May 31, 2010. These notes are secured by deeds of trust on the properties. We did not assume any of these promissory notes and are not responsible for making any of the required payments under these notes. This responsibility remains solely with HP A&M. However, in the event of default by HP A&M, we may make payments on any or all of the notes and cure any or all defaults. If we do not cure the defaults, we will lose the properties securing the defaulted notes and the water rights associated with said properties. If HP A&M defaults on any of the promissory notes, we can foreclose on a defined amount of Pure Cycle stock issued to HP A&M being held in escrow and reduce the Tap Participation Fee by two times the amount of notes defaulted on by HP A&M. Although the likelihood of HP A&M defaulting on the notes is deemed remote, which is the primary reason these notes are not reflected on our balance sheet, we continue to monitor the status of the notes for any indications of default. We are not aware of any defaults by HP A&M as of May 31, 2010.

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. 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.

Item 3. Quantitative and Qualitative Disclosures About Market Risk**General**

Pure Cycle has limited exposure to market risks from instruments that may impact the *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 May 31, 2010, the majority of our capital is invested in certificates of deposit with stated maturities and locked interest rates and therefore not subject to interest rate fluctuations. We have no investments denominated in foreign country currencies and therefore our investments are not subject to foreign currency exchange risk.

Item 4. Controls and Procedures**Evaluation of Disclosure Controls and Procedure**

We maintain disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-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 May 31, 2010, 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.

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Changes in Internal Control Over Financial Reporting

None.

Part II

Item 6. Exhibits

Exhibits

- 3.1 Articles of Incorporation of Pure Cycle Corporation Incorporated by reference to Appendix B to the Proxy Statement on Schedule 14A filed on December 14, 2007.
- 3.2 Bylaws of Pure Cycle Corporation Incorporated by reference to Appendix C to the Proxy Statement on Schedule 14A filed on December 14, 2007.
- 4.1 Specimen Stock Certificate. *
- 31 Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.*
- 32 Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.*

* Filed herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

PURE CYCLE CORPORATION

/s/ Mark W. Harding

Mark W. Harding
President and Chief Financial Officer
July 9, 2010