ISSUERDIRECT
Trading Under the Symbol: ISDR

Transcript of
Pure Cycle
Third Quarter 2017 Earnings Call
July 10, 2017

Participants
Mark Harding – President and CEO

Analysts
Mason Matschke – Raymond James
Rick Jeffrey – Champlain Investments
Bill Miller – Hartwell
Elliot Knight – Knight Advisors
Bill Cunningham

Presentation

Operator
Good day, ladies and gentlemen, and welcome to the Special Investor Call. All lines have been placed on a listen-only mode, and the floor will be open for questions and comments following the presentation. [Operator Instructions].

At this time, it is my pleasure to turn the floor over to your host, Mark Harding, President and CEO of Pure Cycle. Sir, the floor is yours.

Mark Harding – President and CEO
Thank you. Thank you very much, and I'd like to welcome you all to this investor call. A little bit unusual for us as this is kind of an interim call, but enough exciting news has occurred recently that I wanted to bring a little bit more color and a little more detail to specifically how the company's proceeding with some of its core assets, and it coterminously occurred at about the same time as our third quarter financial results, so we will incorporate some of those financial results as part of the presentation. But for the most part, what I'd like to do is just kind of highlight some of key elements of the initiation of starting development at Sky Ranch.

For all of those that are listening on the call, you can find the slide deck for this call on our website. It'll be on the home page. There'll be a link to it on the home page. It'll drive you to where the link is, and it'll be sort of the nine months ended May 31, 2017 slide deck. So that'll give you a path to get to the deck for this. And then as part of my presentation, I'll try and note the slide changes as we move through the presentation so that you all can follow along with me on that.

So for the first part, what I'd like to do is talk about our Safe Harbor statement. Statements that are not historical facts contained or incorporated by reference in this presentation are forward-looking statements. I think most of you are familiar with forward-looking statements, but that's our slide 2.

Real briefly for those that are new to the story or new to the company, we're a water utility company. At our DNA level we provide water and wastewater services here in the state of Colorado. We have a large portfolio of water that we own in an area where you can own water as a real property asset. Then what we also—how we monetize that asset is we're a water utility where we add connection charges to the company's water systems. We also have some raw land that has been fully entitled and is available for development, and that's really what I want to spend most of the specifics of this call on. They're usually to update you on the recent news of agreements that we have with three national homebuilders for development of our first phase of that project, and then provide a little bit more color on some of the more active developments of oil and gas activity in our service as well.

So with that, as many of you are familiar with, we have a fee structure that allows us to collect charges based on connection charges. We get tap fees, and those are connection charges to our system. So our tap fees are currently $26,600 for a water tap fee, about $4,600 for a sewer tap fee. Those are the rates and charges that we're anticipating with our Sky Ranch project. So we get about $30,000 per connection for water and sewer tap fees, and then we get monthly water and sewer bills. So we get about $1,000 per connection on the water side, about $1,500 per connection on the sewer side to give us about $1,500 per connection per year on the monthly water account billing. That's actually an annual number, but we bill those out on a monthly cycle.

So let me talk a little bit about our Sky Ranch project. Those of you who are not familiar with where this is at, this is along the Interstate 70 corridor. So we are positioned exactly four miles south of DIA. We're about 16 miles east of downtown Denver.

The project as a whole is about 930 acres. We're zoned for about 4,400 single-family homes and that's a mix of product between standard detached single-family homes as well as some multi-family homes. We have about 1.3 million square feet of commercial area along the I-70 frontage there. We have about a half a mile frontage along the interstate. We have that quarter section reserved for commercial development. In total this represents somewhere close to 5,000 single-family connections if you add up all of the—kind of depends on the commercial use, but the residential plus commercial use would be about 5,000 single-family equivalents.

So if you look at this one specific asset for the company at the water utility level, that generates about $120 million in water tap fees and about another $25 million in sewer tap fees, so about $145 to $150 million in tap fee revenues. Then at that $1,500 per connection fee, you're about $7.5 million year-over-year revenue.

The next slide, slide 6, will really give you kind of an aerial orientation and maybe some of the activity that's going on in the corridor. The Denver metropolitan market is extremely active. It's in the top five of the most national major metropolitan area economies. We have a very diversified economy, a very highly motivated, a very educated young workforce. So there's a high attraction for all sorts of industries in the area. Where our positioning is, we find ourselves kind of in an area where we have a tremendous amount of employment activity.

The airport itself, which is about four miles directly to our north, has somewhere close to 30,000 jobs. There's a new convention center hotel that's being built in the city of Aurora, the Gaylord Hotel, and that's currently under construction, a massive project. It's about a 5,000-room hotel, will generate I think about another 2,500 jobs.

We have most recently announced an Amazon fulfillment center, which is really two miles from our property which is another 1,000 jobs to the region. So you have a high concentration of economic activity really being invested in this corridor, which is terrific for us. I mean, we're looking at meeting the market potential for development activity not only for our single-family product, but also capitalizing on some of those opportunities in the commercial corner and being able to bring some employment and some of that metric into the project as well.

So I want to focus on slide 7. Slide 7 will really allow me to kind of delineate. It has a lot of information so I'll spend a little bit of time on this to kind of drill down on what we're doing with this particular phase. This first phase is 155 acres. There's a small five-acre outparcel there, so we don't control the entire 160. But what this enables us to do is we had looked at a number of different configurations to bring this to market. We're looking at marketing not just the first phase of our project, but looking for builder partners that were interested in participating in all phases of what we're doing or all residential phases of what we're doing.

So we had talked to as many as ten different homebuilders, and these are all large, national public homebuilders that do business here in the Denver market, and really trying to get a feel for whether or not they had product or whether they had interest for what it is that we we're offering. This particular project that along the interstate corridor, we have the opportunity to really develop this out for an entry level project here in the Denver metropolitan area. Entry level here is probably starting at around high $200,000s/low $300,000 price range for single-family detached homes.

To give you an appreciation for how that metric is, historically the Denver area had seen 50% of all new home starts. All new home single-family detached home starts have really concentrated their market segments in that entry level product. Just because of either land availability, projects far enough along in the entitlements, projects that have access to all of their zoning, their utilities, water/sewer, transportation, the limitations on projects that are ready to go on that, that number has really fallen to about 4%, so it has probably the most—the highest underserved market segment of the entire metropolitan area is really that entry level product.

So we found a tremendous amount of success talking to the national builders because there just wasn't very many projects that had lots that they could compete in the entry level area. Not only was it a limited number of that, but then the project of this size that would have maybe as many as 4,000 units that were going to be concentrated in that entry or first move up market gave us a tremendous opportunity in the marketplace, and we saw that in terms of the reaction that we got from multiple builders in the area.

As our discussions continued with the builders, there were a lot of builders that were interested. The three that we ended up getting contracts with—we got contracts with Richmond American Homes, KB Homes and Taylor Morrison—those three were sort of the first three that had expressed an interest in that. They were the most active on bringing that interest to a contract stage and were able to get contracts with each of those three. We signed those.

We announced those sort of within the last ten days and are really excited about bringing these builders into the project. Not only are they interested in this first phase, but they have interest in phases beyond this. So each of them have very distinct product segments that they're going to be putting on this particular one. We think they all complement each other rather than compete with each other in terms of what their offerings are looking for. Each of them has a sizable enough inventory to make a significant marketing effort to bring traffic to this area and then also be able to push on into the next phases and be able to take a look at lots in the next phases.

What this will try and delineate for you is some of the investments that we're going to be making and then how we're going to be able to monetize each of the individual lots. We are developing finished lots for all three builders. Two of the builders were working under a platted lot agreement where they're going to buy platted lots and then we'll have a development agreement that we develop those lots on their behalf. Then the third builder has an incremental where they're just buying finished lots.

What this illustrates is some of the regional offsite improvements. So we will be responsible for clearly the water and the sewer utility systems, which those were kind of our bread and butter—the orange/tan area. There's a brown area and an orange area—that orange area will be the master plan site for our sewer plant. So we have an initial cost estimate of our wastewater treatment facility that'll be around $5 million, which the company will invest into.

This will be a zero discharge facility, so we will take 100% of the water that comes out of that plant. We'll bring it back to a reservoir that we currently have, and we'll be able to reuse that water for our irrigation water supplies for the community itself. So all of the parks, the open space, the common areas of this area will be irrigated with the return flows from that water supply.

We have some drainage improvement, so the green area will highlight some of the drainage improvements that we have to do in that area so that we can retain the flows not only from this particular parcel, but this is a master plan site where we will be able to retain any storm water runoff flows from the phase two property, the other portions of our property as well. So we're designing that at its build-out capacity to make sure that we can manage the storm water drains there. So that's about a $2 million investment.

There's the entry road monument. So we have the Monaghan road, which will go from the interstate itself. We'll develop about the first mile of that roadway to get access down to another thoroughfare there, 6th Avenue, and then extend about a half a mile of that along the southern border of the property for our second entry in a later phase of that. That entry road, Monaghan Road, will be about $2 million.

Then we have some additional investments in finished water treatment. So we'll have a finished water storage tank. We'll have about a one million gallon storage tank for us to allow us to deliver max day water flows, as well as just a little bit of fixture pump station and works like that. So we have about a $3 million investment in that. So all in total, if you take a look at some of those offsite construction costs, that's about a $12 million investment.

Then drilling down into a little bit more detail, we'll have how we're going to phase this for each of the three builders. So the brown area really represents about 200 lots and that's going to be divided amongst all three of the builders. So 200 lots and we can go in and we can do some over lot grading, some sub excavation. We can take a look at the roads, curbs and gutters, the water, the storm sewer, the sewer collection. All of that infrastructure will be in the brown area for our first phase of this, and that's common area for all three of us. So it allows us really to take advantage of some economies of scale, be able to phase in some of that infrastructure, be able to deliver lots to each of the three builders on that, and then also have our ability to incrementally expand beyond that.

What that allows us to do is we'll also be able to phase in some of the streets in that. So we can do—the over lot grading will have to be done all at once, but we don't have to build all of those streets all at once. We can be much more real time in some of those streets in delivering those as each of the builders take down their individual lots. They have quarterly lot purchases, and each of them have slightly different lot purchases, but each of them will have quarterly lots purchases from us that allow us to be able to expand that out on a real time basis.

Really the opportunity here was what we wanted to do was work with all of these builders such that they weren't required to inventory too much infrastructure and neither was the company, and that they would be able to make certain investments. For example, they'll be buying some platted lots. They'll be making some progress payments to us as we complete certain portions of these facilities to allow us to mutually be in a position where we're each improving each other's cash flow. So we're using some of those progress payments to be able to invest in the over lot grading and the roads and the curbs and gutters and the additional infrastructure to deliver those finished lots.

Where we're at in the overall cycle of how we're going to deliver these finished lots, we have final plats and final designs for the community already filed with the county. We have some hearings with them this month as well as into next month. Anticipate that by the end of August we'll have substantially all of the remaining construction drawings and all of the detailed grading plans established, reviewed by the county and approved by the county engineering staff, road and bridge staff and all of those elements.

So what we'd like to be in a position of doing is be in a position sometime in that September/October timeframe—probably closer to October—soon as we have all of those plans finalized from the county, we'll go to bid to the market to allow the market to be able to help us do this construction portion of that. Some of the water and the sewer facilities might be bid a little bit prior to that because those are a little bit farther along. The water facilities are a little bit farther along. Then we'll get the sewer facilities.

We're nearly done with the design on the sewer facilities, so those will be looking to be bid sometime later this summer as well, get those under construction such that we can be in a position to deliver finished lots to the builders sometime next spring so the capital [audio disruption] really our [audio disruption] would be extending for April/May timeframe, so being in a position where they can [audio disruption] out there sometime in that timeframe and capture some of that market to be able to [audio disruption].

We can build [audio disruption] here. It's a little bit challenging for us to do some of the roadway improvements. So we don't like to do a lot of the asphalt or the concrete over the winter. So what we'll need to do is be in a position to inventory some of those roads and the curbs and gutters on that such that we are giving them an inventory that they can build year round on that.

Then the [audio disruption] from the first phase, we can pop out and expand incrementally for each of the builders, whether we do that in one cycle so that we hit all the corners for each of the three different builders, or for one builder at a time. We can do either of those. It kind of depends on the absorptions of each of the builders and how each of their individual units are taken down and how their product lines are going. So that kind of gives you a feel for this.

If you look at the total investment, we're projecting that we'll probably look to invest about this $18 million and then be able to expand off of that. We'll be getting some of those dollars from the builders as we do progress payments, and then from there using the sale of the finished lots to be able to expand out into the other phases of this, whether that's going to be individual phases for each builder or a collective second phase. This may very well go in two phases where we do one phase which includes all three builders in a common area interest and then one phase for each builder individually. It kind of depends on how the market firms up on that, but that's a look at how this phases for us, how we deliver each individual lot.

Some of the economics on this, generally speaking, we're selling lots. So it depends on the size of the lot, whether that's a 45-foot lot or a 50-foot lot. Lot prices will range from $67,000 to $75,000. So call it round numbers, $70,000 per lot we'll get for the sale of the finished lot.

We're estimating—and this will firm up once we get to bidding that out at—we're somewhere in the $50,000, $55,000 range for finished lot costs. So we'll get a determination on that once we bid that stuff out, and how we cash flow that is a little bit of what I've described in how some of those cash flows work. Then as we've talked, we'll get the sewer tap, water and sewer tap fees attributable with that. So round numbers about $100,000 per lot for each of these individual lots between the land value and the water and the sewer charges.

Moving on to the next slide, what that really illustrates is where we're going to next. So later this year I would say about that same time when we're positioned to send this out to the market for contracts for bidding on the construction and the grading stuff, we'll be starting the land plan on the next phase of it, which will be 480 acres. That'll be a pretty large undertaking for multiple different types of opportunities for the company.

We'll have 160 acres right there up along the interstate that we're going to take a look at a lot of the commercial, retail, light industrial type development. So those are an area where the company will take a look at more like super pad sites. We're not going to any of the vertical stuff, but if we can create five-acre pad sites or any size pad sites where specific users will have a variety of options for them, they'll have a flex plan to allow us to react to the market and what it is that they're looking for on that.

Then as you transition south, we'll probably transition into some multi-family residence. We'll take a look at some attached single-families, these paired products. We have a number of builders that have interest in the paired product where they can have side-by-side units, and then again focusing on the core strength, which is going to be our detached single-family product.

So this will be much larger in terms of the number of connections and the number of units. This should be somewhere between 2500 and 3000 SFDs. A lot of that's going to be dependent on the scoping of the multifamily and a lot of the type of development that we have on the commercial side. But this will be the real lion's heart of the project. Again, we want to be careful such that we're delivering a lot of this infrastructure on a more real-time basis.

The bulk of the—hard part is always going to be opening the project, and we've been able to be fortunate to have an existing water system that the pipeline has been developed up to the property. We have adequate capacity to provide build-out water for this and some of that capacity is being used already in the industrial segment of what it is that we're doing. But it allows us to have sufficient water supply for all of the development, and then we can incrementally expand on some of that stuff in the horizontal development of the project as well.

Whether the company does all of the horizontal development or just some of this horizontal development will kind of be a function of what our experiences are with this first segment. I would say that we have been very encouraged by how we've been able to market this, how we've been able to contract for this, our current performance on being able to bid a lot of this work out to be able to manage that work and be able to see it through to completion.

We have a great management team. We have a great field team that have been able to do that, and we have some very outstanding help at the board level. So a lot of that has really helped with our successes in bringing this project to market.

If we move to the next segment, this is going to be an illustration of sort of some of the commercial layout there where you come off of the interstate. This shows kind of a jog off of onto the interstate and some of the transportation network and our ability to deliver a multitude of types of lots and pad sites for infrastructure in there.

While our zoning is up to about 1.3 million, we can certainly go beyond that. Certainly that's a market-based principle, and some of these layouts are showing as many as 3 million square feet of commercial development, which I think will be at—all indications to date have been that there's a very significant interest for commercial development at this site just because there's not a lot of competition or there's not a lot of availability for other types of commercial development in this area. So we're interested and certainly we'll see how that plays out.

We have some professionals that are helping us with this. We're working with CBRE [ph] on a listing right now for some of this engagement. So we'll see how that kind of transitions over the next few months.

Let me give you a quick update on some of the oil and gas activity in the area. So slide 10 really kind of illustrates our footprint in terms of where this lease area is. As most of you know, we have about 200 square miles in Adams and Arapahoe County, right on top of where our water systems are that are in active development for oil and gas interests.

We do have two rigs currently servicing the area, so we have one rig that has drilled its fourth well. I think it's relocating to its fifth well pad site. Then just within the last two weeks we had a second rig show up for another operator that started its first well, and I think they're on a four-well program for this year. So we could see somewhere around 12 to 15 wells this year depending on the second operator.

I think we have a little bit more confidence in our major and larger operator in the number of wells that they have planned. I think they have nine wells planned for this year and then will be moving on. There's really three operators now in this field who've picked up leasehold interests.

The third operator has given us an indication that they're going to be pretty aggressive about their drilling program in 2018, but until they get a number of their wells finalized and some of the infrastructure in terms of how their gas collection system works, they're looking at bringing a rig in late this year in that December of early part of 2018. So we may see as many as three different operators collectively working their leasehold interest.

Still to date this is really being drilled for hold by production. We don't see a lot of field development yet. One of the wells that are being drilled right now will be a two-well pad site. I think there's two wells that are two-well pad sites, but then as they start to transition into this, you may see as many as 16 to 20 wells per pad site. The third operators had a little bit of discussion with us about that kind of activity, so we'll wait and see how that pans out.

Moving on to the next slide. That's just a little bit more information. One of the interesting things that I will highlight about this is a couple of different frac designs. So traditionally a frac design has used about 10 million gallons of water, and that transitions to about $100,000 in revenue for us on that. But we did have one of the new operators that actually used a new frac design that doubled that. So they were even in excess of $200,000 in terms of the well—the water for that particular well design.

They were very happy with that. They think that might be the model that they go to. I think we might see one or two of those high water use designs this year so that they can continue to compare what the results of those types of wells are to the traditional design. But certainly we have the water available for that system.

Drawing your attention to slide 12, this is our Wild Pointe acquisition. So this is an existing water utility that we entered into an agreement with towards the end of last year. What I really do want to highlight is this is really working out nicely for us. We have a number of taps that have been added to this system, so I think we've recorded about $43,000 in tap fee revenue attributable to it. We should expect to see somewhere in that $60,000 to $80,000 in tap fee revenue this year attributable to that. Then generating just monthly service revenues I think we have somewhere between $50,000 and $60,000 a month in annual water revenues.

We have not hit the summer peak season yet, so a lot of that's going to be seasonal. This is working out very nicely for us, just exactly down the middle of fairway in terms of what it was, our expectations about how we modeled it, the number of opportunities between the commercial corridor as well as expanding out the residential and building out the rest of the remaining residential out there, so one that we like.

We have a few more mapped out for other opportunities similar to this in the same vicinity that certainly would make sense for us, ones that we think would make sense for the owners of those systems as well. We can bring a number of value adds to this in terms of our operating those systems and then maybe ultimately in the future bringing new water to the region and being able to expand development opportunities on the property. So those are things that we look for and continue to have an interest in, but they have to meet our investment criteria for that. So we're very careful about valuations on how we do that.

Moving on to the next slide, I want to just give you a quick update on our WISE project. Many of you heard me talk about WISE over the years. What this is is a regional water system. We are fully finished on completing our WISE interconnect. What that really does is allows us to move water to and from in addition to infrastructure capacity and expanding our footprint in terms of where and how we can deliver water. It also includes additional water.

So it really doubles our water capacity in our system, which allows us to be able to develop Sky Ranch at the same time keep up with three rigs that may be working the field. So it's a terrific opportunity both for us to supply water and expand our infrastructure and our footprint and our delivery capacity, but it also expanded our ability to partner with other water providers in other geographic areas where we can look at service opportunities throughout the reach of this system. So we're very excited about that. That has been tested. It has been flowed, and so we're one of the first parties to be able to take water deliveries from that system.

Some of the other providers are continuing to finish out their infrastructure and be able to complete deliveries of their water to their system. Some of those will extend into 2018, but some of them—I'd say two-thirds of them—should be finished sometime by '17. But we finished our system sometime in that April timeframe, so we're very excited about that opportunity.

Let me just give you some of the highlights on the numbers. You'll see some drilling frac revenue. So that was one frac. So we had to the 221.7. So that was that new design of that frac. So we had a nice increase in water deliver opportunities for that. They're currently fracking. We have that four-well inventory right now, so we'll start to see back-to-back fracs of water all summer long. So you'll start to see that additional revenue show up really mostly in that fourth quarter and then balancing out the calendar yearend for that water delivery.

Our municipal revenues are seasonally up a little bit this year. We had that 25% increase that I will call that more a little seasonal delivery increase and then oil and gas. One of the things that I will draw some attention to is we had—one of our wells was down for most of our third quarter. They were doing some maintenance activity on that. We have not seen a full month of production since that well came back online. So I will be interested to see if it stays the same, it if helped or if it hurt to see how their well redevelopment program compares to with what we do in the water business, because we do very similar activities where we'll take a well down. Every four or five years we'll do some maintenance on that downhole activity and we usually see an increase in water activity.

I'm betting that they have got this down sufficiently enough that they're doing it because they want to continue to maintain or improve production out of the well. We've been very pleased with these wells. These wells continue to produce about 300 barrels a day. So we're generating around $25,000, $27,000 a month in revenue as we get full month revenues out of these wells. They're predominantly oil wells. I think they're about 70% oil production on it.

So the last two slides are going to be just a balance sheet income statement for the nine months operation. I'm not going to review those. You all can take a little bit more detail on those. So what I'd like to do is kind of open it up to questions and see if I've answered all your questions, terrific. If I haven't, I'll try and give you a little bit more color. So I'll turn it back over to the operator, and we'll queue up for some questions.

Operator
Thank you. The floor is now open for questions. [Operator instructions]. All right, our first question comes from Mason Matschke from Raymond James. Please state your question.

Q: Hey, Mark. Congratulations on closing the three builders. Great job.

Mark Harding – President and CEO
Thanks. We're very excited.

Q: My question was, if you could just talk a little bit more about the potential commercial sales and what the expectations are for that and maybe the timing of that.

Mark Harding – President and CEO
So the commercial from a land value is really very significant by comparison to the residential side. I mean, where we might make a few—maybe $20,000 a lot on the residential side, the commercial side you can make significantly more in an equivalent amount. So that's the type of thing where you sell it on a price per square foot. Those price per square foots, can range from maybe $3.00 to $7.00 a square foot. So on the first few sales, you might see those being at that $3.00 a square foot, but as the commercial kind of matures you're going to see a much, much higher number in terms of what you're getting on a price per square foot.

The other side of it—so not only do you get a lot more in terms of the residual land value—we do see a highly improved value in terms of water for those commercial opportunities as well. A standard single-family tap is one tap, but when you take a look at a five-acre pad site for commercial development, you may sell 30, 40 taps on a five-acre pad site. So it kind of depends on the type of users that you have, but you see really a compounding effect for both land value as well as the water utility.

The biggest thing that we found for most of these commercial opportunities in the marketplace is that we're ready with all of the water and the sewer side of it that we have full build-out utilities for commercial, and they're unconstrained in terms of what they can put on that commercial facility from a water standpoint gives us a very competitive advantage on that commercial.

Q: That's fantastic. Thank you for the explanation.

Operator
Okay. Our next question comes from Rick Jeffrey from Champlain Investment. Please state your question.

Q: Hi. Good afternoon, Mark. Congratulations again to reiterate the previous comments. If you wouldn't mind just talking a little bit about—if you can—a bit more specific in kind of timing. Then also, you had mentioned several years ago on a call about what you were thinking about doing about use of proceeds, and that's kind of a little bit premature. But would you expect a dividend down the road, a share buyback? That would be kind of a two-part question, so timing over the number of years and then what you might be doing with some of this money when it comes in.

Mark Harding – President and CEO
Okay. Good question. So let's say that all things are predictable in the world and that we're only just dealing with capacity constraints. Setting aside the market question, really a lot of these production builders really like to be in a position where they can do seven to ten homes a month. So if we have an inventory of 500 homes and I have three builders out there and the market is strong and the market reacts well to their product, you can take a look at this somewhere being between a two- and three-year build out of the first phase of the first 500 lots. The thing that we want to do is kind of keep that rolling average, because the thing that you don't want to do is once everybody gets rolling and gets some momentum up and the market has a lot of penetration and a lot of traffic, you want to keep delivering those lots.

I think from an infrastructure standpoint, we're very well phased on that because we have water that's going to be available for that. Our initial sewer will have a significant capacity. We can't build just sewer for the 500 lots. So our sewer side is going to be somewhere around 1,800 units worth of capacity. So we'll have additional capacity within the sewer that's going to be unconstrained. Those being the two long lead items really will be just expanding out the zoning. It'll expand out some of the land plan.

We have our existing zoning that we can just flex within and take that second phase into a more detailed plan than we have today. So if you look at it—if all of the momentum stays strong from the first phase through build-out, that could be about a ten-year build-out for the entire project.

On the high quality question, what do we want to do with all the money? Great question. One of the reasons why you and others like to own water utility companies are they do have dividends. The company looks at—I'll tell you from the management perspective as well as likely—and I'll speak very high level for our board, but we would look at dividends through cash flow.

So we really do want to make sure we have adequate revenues to cover our overhead to be able to do the operation and maintenance and then see how that additional capacity can be used to reward our shareholders. I mean, that's the key to owning any individual equity is that you want to be rewarded for that ownership interest, and that's one way that we would do that.

Another way that we can do that, I think we look for opportunities to invest in other water systems. So something similar to Wild Pointe where we can cast our nets out and find acquisitions opportunities, I think that's a good use because there's a very significant efficiency standpoint. I think the company has the ability to bring value to those. So where we're bringing value that can be translated into return to shareholders. So if we have opportunities, we'd look for those opportunities as well.

Again, those are going to have to meet our investment criteria on those, and they're going to be logical for us, but the perfect candidate for us would be someone that would have an existing customer base and have a need for new water where we can expand our infrastructure to deliver water to them and be able to not only pick up the existing connections but new service connections and diversify our service area beyond sort of where we're at with Sky Ranch and where we're at with Lowry [ph]. So those are opportunities.

Then share buybacks are certainly in consideration. Those are kind of sort of a balance sheet item where we would take a look at our cash position and where our market cap is and where the market understands that. To the extent that there's an opportunity for us to be able to lower that denominator, it's something that we would consider. I think we probably have better opportunities in the first two than the third, but as those cash positions continue to build, that's a great use as well and a great way to continue to reward and monetize our assets and our currency, which is our equity for our shareholders.

Q: Thank you. Then just a quick followup if you wouldn't mind. So that would imply that your margins would be slightly better on ongoing phases because a portion of what you're laying out for phase one will have higher capacity than what your phase one needs will be.

Mark Harding – President and CEO
Yes. If you really try to balance out the investment to where we add capacity in the system, I think that's right, Rick. We may have a little bit more investment on opening, which you typically do, and then I think that will continue to return to us as we add additional phases to the project.

Q: Well, Mark, thanks again. You've done a really wonderful job with shareholders. So thank you for your stewardship.

Mark Harding – President and CEO
Well, thank you for your patience.

Operator
Okay. Our next question comes from Bill Miller from Hartwell. Please state your question.

Q: Mark, the buildup of cash, how much cash are you going to have to put into this operation, both commercial operation and the residential operation? It sounded to me like it was $8 million. Is it more than that, I mean, just initially and then you start getting return on that, or how much are you going to have to spend?

Mark Harding – President and CEO
That's a good question and really kind of a function of some of that phasing. What I think we'll have probably I'd say $12 million of water/sewer drainage and entry roadway investment. Then the land side—the real trick for us, Bill and all that are sort of listening, the real trick for the company on extending into being a developer wasn't that we had a compunction or really a compelling desire to be a developer, but it was that we really were a developer by virtue of what we were going to do on the front end of a project anyway. Water and sewer utilities for particular projects are probably the single most expensive component of that, and that's something that we felt we were well-positioned to do.

We understood that business. We have the expertise to do that business. Then getting into expanding beyond that, one of the things that we tried to do was work out a win-win relationship with builders such that they didn't have to inventory a lot of taps because we could provide it to them on a real-time basis, and they were more accustomed to buying those taps on a real time basis, and instead be able to help us on some of that horizontal infrastructure.

So we were able to use a lot of those cash flows that they would have otherwise had to buy tap fees in that area and be able to redeploy that into the land side so that we didn't over extend ourselves on the land side. So we have 12 we know that we're going to do on the offsite. The additional six, some of that's going to time out very well. It's going to exactly time out where I get it before I have to spend it, but I'll be getting it while I'm spending it and so I have these progress payments.

We were probably looking at being no more than $15 million, $16 million negative at any one time. Then once we do get there, the takedowns because of the capacity issues become very quickly that you may not even see some of that because it's going to be inter-quarter in terms of the timings of those cash flows.

The commercial stuff and then as you expand into the second phase, we'll be riding off of the first phase development and have capacity in our system on the water and the sewer side to give us a lot of that leverage where we don't have to be that negative or we don't have to have that much money invested into inventory, not negative, but I always look at that as capacity in an investment where we might have $16 million, $18 million of investment into that first phase. As we move into multiple phases it wouldn't surprise me that we are half that in terms of where we're at because—then again, we'll grow into capacity of each one of those.

If you take a look at how we look at the phasing, we won't be needing a lot of that capital after this first phase, if that answers your question.

Q: Well, it answers the question. What it really does is tell me that you have right now on your balance sheet more than enough cash to satisfy either the acquisitions of water systems or to build out these two phases, commercial and residential. Is that correct?

Mark Harding – President and CEO
That is correct. We are in a very good position to capitalize on many types of opportunities, so we want to be careful about them. We want to make sure that they meet our requirements, and so it gives us the flexibility that we can pursue those as they become available.

Q: Sounds great, thanks.

Mark Harding – President and CEO
You bet.

Operator
Okay, our next question comes from Elliot Knight [ph] with Knight Advisors. Please state your question.

Q: Hi, Mark. I think I heard you say if all goes well, the first phase of Sky Ranch, 500 lots, builds out in two to three years, and the entire project, if all goes well, could build out in ten. Is that right?

Mark Harding – President and CEO
Yes.

Q: Okay, within that, there is the highly profitable commercial segment of it. When, from now out to year ten, in that timetable, do you see commercial coming in and being completed?

Mark Harding – President and CEO
I would say that's probably in the cycle of years anywhere from two to eight or nine. You'll leave some of that. You don't want to build it all at once because those commercial needs mature based on rooftops. If you have existing capacity, and having as much land as we do gives us an opportunity where we can capitalize on some of that. Maybe we get some retail, we get some box stores, we get some opportunities on the commercial side on maybe the second phase, but we want to have that extend into years eight and nine as well because those are where you're going to get the higher price per square foot too.

Q: Yes, you deliberately delay it for profitability reasons.

Mark Harding – President and CEO
Yes, you get some inventory. You want to capitalize on some, but you want to keep some inventory for other uses later on.

Q: Okay, now, you have an awful lot of water available for sale. You have, I understand, projects in the area that are at different phases of possible future development. Could you talk a little bit about them, and their size, and what they might mean for the company?

Mark Harding – President and CEO
Good question. Really our sandbox, and I'm going to say our focus of development on the utility side is going to be the I-70 corridor. There could be as many as 11 miles between Sky Ranch, and we operate a water system for the town of Bennett about 11 miles, which will be a number of interchanges between Sky Ranch and Bennett, but from a long-range planning perspective, there's a tremendous amount of opportunity along that corridor.

There's large land owners that own very significant positions there. Some of them have their entitlements. Some of them are pursuing their entitlement, but it would far exceed our capacity. Our direct neighbor, for example, has zoning capacity somewhere in that 15,000 lots, so about three times the size of Sky Ranch. They need additional water supply. They have some water supply beneath the property themselves that they can get started with some of the water supply that they have. They are moving forward.

I know that that they're watching us as much as we're watching them in terms of what types of successes that we're going to have with our residential stuff. I think they're leading with some residential. They have their infrastructure issues where they have to build sewer plants, and drainage, and they have school issues, and a bunch of things that they're working on their project. Those are all opportunities for us, and that's just the corridor.

Then, you take a look at our Lowry Range, which we have our service rights on Lowry, and there's 30,000, 40,000 unit potential there. We had a developer prior to the downturn of the real estate cycle that was engaged to build a project out that was somewhere around 13,000, 15,000 units. There's that land as well as land all around it, and then maybe south of the reservoirs that all are very attractive opportunities.

We don't control that land, but the market has a way of making offers that people can't refuse for development. If the market stays robust, as it is now, we will go through cycles. We're anticipating going through cycles, not only for Sky Ranch, but we have capacity to serve 60,000 units, so there will be cycles to that.

We'll, have good years where we bring a lot of inventory on and then we eat through that inventory both within our service area as well as contract services for neighboring properties along the I-70 corridor. All of that is opportunity for us which far exceed our capacity to provide service to.

We do have water. We're long on water. As quickly and as opportunistic as we want to believe in that, the region as a whole is very short on water. There will come a day where the company will have committed its portfolio, and then we're working on how we develop that with the number of contracts that we have.

Q: Right. Now, the paragraph that is in the most recent 10-Q about track water sales, as far as I can tell, that is a completely new paragraph. It seems to me substantially important because basically aren't your frac water sales basically pulling from inventory that you have and wouldn't sell for many years in the future, but you're now monetizing them?

Mark Harding – President and CEO
It does. That's one way of looking at it. The other thing that is helpful about that is that we have the ability to have current use of that system. We have invested into a system, and anytime you invest in a system, you have to invest in fund sizing that allows you to grow into that system.

Well, while we invested, we built a 24-inch line that goes from our Lowry property up to Sky Ranch, and that far exceeds what we can serve within Sky Ranch, but we do have demand for that in the oil and gas space. If it turns out that we have additional contracts that we can extend service to our neighbors to use that capacity of that 24-inch line, we still have the ability to monetize that line in the interim. We are very fortuitous to have that oil and gas as a customer because it allows us to bring those systems online.

The other side of it is when they want water, they want a lot of water, so there's some peaking issues attributable to that that we have been able to develop for them and that we can use those peaking facilities over time to meet the peaking demands we have on the municipal side. It's a very complementary framework. Oil and gas may allow us to use some of those peaking facilities year-round where after the summer irrigation season declines, we have excess capacity in that system the rest of the year and just continue to use it. It's a matter of managing those two accounts, and it really does provide a unique opportunity for us.

Q: Well, one of the reasons I'm interested in the immediate drilling activity is as soon as a well is completed, you start that cycle towards leading towards re-fracs. You have about 40 plus wells drilled there now. Where do we stand on the re-fracs of the first wells that were drilled out there?

Mark Harding – President and CEO
Great question, sounds like a question from an oil industry analyst, going back to your old days. The industry as a whole takes a look at those re-fracs. Our wells are relatively new, and as I understand it, those are typically every five or six years, so we are just about to mature up to some of the early portion of that with some of those wells. We have not had a re-frac of an existing well, but we'll be interested to see that not only in terms of what the water demand is but also how that changes the production profile, where it returns, and then again the decline curve of the typical shale oil plays, but if you take a look at the inventory of total well capacity, and then a re-frac of well capacity, terrific opportunity for us and our shareholders.

Q: We must be then getting close to the first of the re-fracs.

Mark Harding – President and CEO
Time-wise, I think that's true.

Q: Time-wise, yes, time-wise.

Mark Harding – President and CEO
Time-wise, I think that's true, but we have not heard from any of our operators about an opportunity to re-frac to date.

Q: Okay, good. Thank you.

Mark Harding – President and CEO
You bet.

Operator
Okay, our next question comes from Joe Cunningham [ph]. Please state your question.

Q: Bill Cunningham, am I on?

Mark Harding – President and CEO
Yes, you are. Go ahead, Bill.

Q: Okay, yes, hi, Mark. These slides in your presentation are great. I find them very interesting, and detailed, and actually have a couple questions on the roads for you. The first is on Monaghan Road coming in. It looks like most of it is right on the border of Sky Ranch. I'm wondering whether it's entirely on Sky Ranch property or whether half of it is on the neighbor's property.

Mark Harding – President and CEO
Good question. That's a section line, and so anytime you get a section line road, what happens is you get half the road on each side of that section line. In the initial development, what we're doing is we're building, if you take a look at the entry part of that, there's a half a mile that we extend that'll be along the commercial corridor. Then, it gets to where we would be on both sides of the road.

We're going to build the three lanes on our half of that section line, and then as we get down to where Sky Ranch is, we cross over and we build the three lanes on our property to the west of the section line. Then, when we go for the second phase, we'll build the three lanes on the east half of that section line. Ultimately, we will have to fill in the other three lanes on the neighboring property owner's half at some point in the future.

Q: Okay, and then does that become then public, I guess, does that get deeded over to the State of Colorado or the county or something? I assume it no longer—

Mark Harding – President and CEO
It does. It does.

Q: Okay.

Mark Harding – President and CEO
Yes, the county has the requirement that they have to get those roads. Then, they maintain those roads. We build them to their standards, and then we dedicate, and it's typically on section lines, it's 144 feet to allow you to have 6 lanes, 3 lanes on each side.

Q: Okay, good. On the road at the bottom of this new section, which I believe it's what, East 6th Avenue, is that right?

Mark Harding – President and CEO
That's right.

Q: Okay, it's kind of interesting. I know that East 6th Avenue comes out from Denver, then it stops. Then, it starts again at East Gun Hill Road, and goes into that development to the west of you, and then it looks like it stops again. I know there's plans for some construction going on from development to the west of you toward Denver. I'm wondering if there's plans to ultimately connect this section of East 6th Avenue into the development to the west of you, and then basically become another route into Denver.

Mark Harding – President and CEO
It would be. It would be a tortured route, but it would give you access through it. Really, the interesting thing about that will be there's a half a mile that would be between our property and where 6th Avenue is. We obviously don't want to pay for that because it's really not our property, and the neighboring property owner obviously would rather have somebody else pay for it.

A lot of those types of infrastructures are funded under if somebody's first to build a road like that, they're funded under reimbursement agreement. When the property that it benefits does develop, they have to reimburse the person that did actually make that road happen. That half mile of road is an interesting aspect for us because what that does is it puts into play all of those homes on our neighbor to the west.

There could be as many as 3,000 homes over there, and we could see a lot of commercial opportunity traffic going by our interchange with those folks going home that way if we open up that road. That would be one of our calculuses on the commercial development is that may be something where we would invest in that road and get a reimbursement on that because it would accelerate some demand and some revenue for the commercial.

Q: Yes, because it's really just getting the half mile over to what, Powhaton Road, I believe it is?

Mark Harding – President and CEO
Yes, exactly right.

Q: The north-south road there that at least once it's there you can roundabout get into that subdivision with D. R. Horton, and Lennar, and things. That looked interesting. Do you have any idea what's going to happen with, or what are the plans might be for that property between Powhaton and your property along 6th Avenue?

Mark Harding – President and CEO
It will likely be residential. I think it's zoned for residential, but it's owned by a passive land owner. The property directly south of that is owned by a much more active developer. It's still in the city of Aurora, so they get their utilities from Aurora, but that's owned by a Canadian developer, and they're very active on that property.

Q: Okay, very good. Well, thank you very much, Mark. This all looks great.

Mark Harding – President and CEO
You bet.

Operator
Okay, that is the final question.

Mark Harding – President and CEO
Well, I'd like to thank you all again for your continued support for this company. We're really excited about where we're at. We're looking forward to the next year and really the next phases of monetizing our assets.

Just a couple of announcements on some conferences. I will be in Minneapolis at the Intellisight Conference on August 22nd, and then I will be at the IDEAS Conference in Chicago on August 30th. So, I have a couple of conferences in August. In the meantime, we are trying to be a bit more active about getting out and talking a little bit more about what it is that we're doing.

So, if we're in markets, we'll try and reach out with some press releases on markets that we're at, and perhaps we can sit down and have some meetings with you folks and other people that might be interested in the story. Other than that, if you want to ask a question that you didn't get dialed in on, please don't hesitate to give me a call. I look forward to speaking with you all again soon.