

Mossberg's Investor Digest

Best Idea Profile

Pure Cycle Corp. (NASDAQ:PCYO)

DESCRIPTION:

Headquartered in Denver, Pure Cycle Corp. is a water and wastewater service provider engaged in the design, construction, operation and maintenance of water and wastewater systems. PCYO has a vertically integrated business model that provides it with all the components necessary to offer complete water and wastewater services. PCYO currently provides water services to approximately 247 single family equivalent (SFE) water connections and 157 single family units. These connections are in the southeastern Denver metropolitan area. PCYO plans to utilize its significant water assets to provide residential/commercial water and wastewater services to other customers located along the eastern slope of Colorado generally known as the "Front Range" (the area east of the Rockies extending essentially from Ft. Collins to Colorado Springs). PCYO is strategically targeting the "I-70 corridor" which is located east of downtown Denver and south of the Denver International Airport. This area is predominately undeveloped and is expected to experience substantial growth over the next 30 years.

KEY INVESTMENT CONSIDERATIONS:

Unique and Valuable Asset: PCYO owns over 12,000 acre-feet of decreed groundwater and surface water rights in the Denver area and has the exclusive right to use, through the year 2081, approx.. 13,400 acre-ft of decreed groundwater and surface water located at the Lowry Range. In addition, PCYO owns approximately 60,000 acre-ft of Arkansas River water which is currently being used to irrigate approximately 17,500 acres of land owned by PCYO in Southeastern Colorado, and 70,000 acre-feet of conditionally decreed Colorado River water rights on the western slope of Colorado.

Demand and Strategic Position: Along the Front Range of Colorado, there are over 70 separate water providers with varying needs for replacement and new water supplies. PCYO believes that it is well positioned to assist certain of these water providers in meeting their future water needs. Based on independent engineering estimates, PCYO's Denver portfolio can serve approximately 78,000 SFE's, while the Arkansas River supplies (estimated to be approximately 40,000 acre ft./year of consumptive use water) can provide water service to an additional 100,000 SFE's for a combined capacity of approximately 180,000 SFE's. The \$103.2 million of capitalized water costs on the company's balance sheet represents the costs of the water rights PCYO owns and the related infrastructure developed to provide water and wastewater services.

Long-Term Demand: Colorado is a semi-arid state with average precipitation of only 17 inches per year in the Denver Metro area. Approx. 85% of the state's available water is west of the Continental Divide. Whereas PCYO's market is east of the Continental Divide which includes 88% of the state's population.

Acquisition: Recently PCYO announced it will acquire the 931-acre Sky Ranch Property for \$7 million in cash. This was an opportunistic acquisition of a note payable due to Bank of America by a bankrupt developer. Pure Cycle anticipates that it will sell divided lots and can partner with developers adding low cost tap fees to attract interest in the properties. This property provides the potential for approximately \$109 million in water tap fees and \$24 million in wastewater tap fees. In addition to solidifying the company's existing water service agreements, this acquisition expands Pure Cycle into wastewater services for the property.

VALUATION:

PCYO is a classic long-term value situation which is currently at the bottom of an economic cycle and has underlying assets to be developed. By taking the present value of tap and usage fees, net of costs, investors can come up with a valuation much higher than the current stock price. Though the rate of new tap sales is unknown, if one takes 180,000 single family equivalent units at a 50% gross profit a present valuation in excess of \$21 per share can be reached.

(NASDAQ: PCYO)

Investment Data (as of 10/19/10)

Recent Price	\$3.34
52-Week Range	2.00 - 3.68
Fiscal Year End	Aug 31
Shares Outstanding	20MM
Average Trading Volume (3 mos)	9,615
Market Capitalization	67MM
Cash	2.6MM
Long Term Obligations	N/A
Enterprise Value (EV)	64MM
LT Debt/ Equity	NA
BV/ Share	\$2.16
TTM Revenue	\$249K
P/ Revenue	NA
TTM EPS	(\$0.27)
P/ EPS	NA
TTM EBITDA	(\$1.5)
EV/ EBITDA	NA

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