PURE CYCLE CORP
Form 10-Q
July 06, 2018

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

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: May 31, 2018
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)
34501 E. Quincy Avenue, Bldg. 34, Watkins, CO	80137
(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, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of July 6, 2018:

Common stock, 1/3 of $.01 par value	23,764,098
(Class)	(Number of Shares)

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PART I – FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

PURE CYCLE CORPORATION
CONSOLIDATED BALANCE SHEETS

ASSETS:	May 31, 2018 (unaudited)	August 31, 2017
Current assets:		
Cash and cash equivalents	$2,876,152	$5,575,823
Short-term investments	17,005,914	20,055,345
Trade accounts receivable	1,218,251	663,762
Notes receivable - related parties, including accrued interest, current	-	215,504
Notes receivable, current	173,249	-
Prepaid expenses and other current assets	1,340,409	503,100
Inventories	2,074,543	-
Assets of discontinued operations, net	86,789	110,748
Total current assets	24,775,307	27,124,282
Long-term investments	189,774	187,975
Investments in water and water systems, net	35,609,275	34,575,713
Land and mineral interests	6,075,834	6,248,371
Notes receivable - related parties, including accrued interest	2,375,352	776,364
Other assets	654,027	424,226
Assets of discontinued operations held for sale	450,641	450,641
Total assets	$70,130,210	$69,787,572
LIABILITIES:		
Current liabilities:		
Accounts payable	$269,025	$492,410
Accrued liabilities	379,336	380,852
Deferred revenues, current	-	55,800
Deferred oil and gas lease payment, current	55,733	-
Liabilities of discontinued operations	5,559	11,165
Total current liabilities	709,653	940,227
Deferred revenues, less current portion	-	999,688
Deferred oil and gas lease payment, less current portion	74,311	-
Participating Interests in Export Water Supply	339,406	341,558
Total liabilities	1,123,370	2,281,473
SHAREHOLDERS' EQUITY:		
Preferred stock:		
Series B - par value $.001 per share, 25 million shares authorized; 432,513 shares issued and outstanding (liquidation preference of $432,513)	433	433
Common stock:		
Par value 1/3 of $.01 per share, 40 million shares authorized; 23,764,098 and 23,754,098 shares outstanding, respectively	79,218	79,185

Additional paid-in capital	171,747,662	171,431,486
Accumulated other comprehensive income (loss)	60,225	(11,105)
Accumulated deficit	(102,880,698)	(103,993,900)
Total shareholders' equity	69,006,840	67,506,099
Total liabilities and shareholders' equity	$70,130,210	$69,787,572

See accompanying Notes to Consolidated Financial Statements

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PURE CYCLE CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(unaudited)

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2018	2017	2018	2017
Revenues:				
Metered water usage	$ 1,162,570	$ 47,695	$ 2,888,913	$ 379,462
Wastewater treatment fees	11,675	6,967	32,157	30,516
Special facility funding recognized	-	10,377	-	31,131
Water tap fees recognized	-	46,978	49,948	54,125
Other	37,874	21,991	95,893	74,952
Total revenues	1,212,119	134,008	3,066,911	570,186
Expenses:				
Water service operations	(418,280)	(76,878)	(906,899)	(234,444)
Wastewater service operations	(6,632)	(7,509)	(21,303)	(22,478)
Depletion and depreciation	(79,772)	(69,013)	(179,913)	(178,394)
Other	(24,243)	(13,649)	(64,822)	(45,921)
Total cost of revenues	(528,927)	(167,049)	(1,172,937)	(481,237)
Gross profit (loss)	683,192	(33,041)	1,893,974	88,949
General and administrative expenses	(635,502)	(518,625)	(1,816,110)	(1,411,410)
Depreciation	(135,488)	(79,388)	(380,065)	(227,643)
Operating loss	(87,798)	(631,054)	(302,201)	(1,550,104)
Other income (expense):				
Oil and gas lease income, net	13,933	6,000	37,156	17,265
Oil and gas royalty income, net	61,113	24,935	152,653	164,338
Interest income	69,027	59,578	176,001	199,242
Other	(2,643)	(2,600)	(7,846)	(7,814)
Net income (loss) from continuing operations	53,632	(543,141)	55,763	(1,177,073)
Income (loss) from discontinued operations, net of taxes	969	(11,275)	2,390	(32,607)
Net income (loss)	$ 54,601	$ (554,416)	$ 58,153	$ (1,209,680)
Unrealized holding gains (losses)	40,613	8,404	71,330	(26,488)
Total comprehensive income (loss)	$ 95,214	$ (546,012)	$ 129,483	$ (1,236,168)
Basic and diluted net income (loss) per common share				
Income (loss) from continuing operations	*	$ (0.02)	*	$ (0.05)
Income (loss) from discontinued operations	*	*	*	*
Net income (loss)	*	$ (0.02)	*	$ (0.05)
Weighted average common shares outstanding–basic	23,764,098	23,754,098	23,759,654	23,754,098
Weighted average common shares outstanding–diluted	23,955,046	23,754,098	23,913,863	23,754,098

See accompanying Notes to Consolidated Financial Statements

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PURE CYCLE CORPORATION
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
Nine months ended May 31, 2018
(unaudited)

	Preferred Stock		Common Stock		Additional Paid-in	Accumulated Other Comprehensive (Loss)	Accumulated	
	Shares	Amount	Shares	Amount	Capital	Income	Deficit	Total
August 31, 2017 balance:	432,513	$433	23,754,098	$79,185	$171,431,486	$(11,105)	$(103,993,900)	$67,506,099
Stock option exercises			10,000	$33	$74,967			75,000
Share-based compensation	–	–	–	–	241,209	–	–	241,209
Adoption of accounting standards	–	–	–	–	–	–	1,055,049	1,055,049
Net income	–	–	–	–	–	–	58,153	58,153
Unrealized holding gain on investments	–	–	–	–	–	71,330	–	71,330
May 31, 2018 balance:	432,513	$433	23,764,098	$79,218	$171,747,662	$60,225	$(102,880,698)	$69,006,840

See accompanying Notes to Consolidated Financial Statements

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PURE CYCLE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Nine Months Ended May 31,	
	2018	2017
Cash flows from operating activities:		
Net income (loss)	$ 58,153	$ (1,209,680)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and depletion	559,975	405,167
Equity loss in Well Enhancement Recovery Systems, LLC	7,847	7,652
Share-based compensation expense	241,209	168,034
Interest income and other non-cash items	(867)	(26,641)
Interest added to receivable from related parties	(46,377)	(18,316)
Changes in operating assets and liabilities:		
Trade accounts receivable	(554,489)	119,452
Prepaid expenses	(926,917)	(164,626)
Inventories	(382,554)	-
Notes receivable - related parties	(62,611)	(86,818)
Notes receivable	(172,698)	-
Accounts payable and accrued liabilities	(224,901)	(90,322)
Deferred revenues	-	(41,852)
Deferred oil and gas lease payment	130,044	(18,000)
Net cash used in operating activities from continuing operations	(1,374,186)	(955,950)
Net cash provided by operating activities from discontinued operations	17,914	116,706
Net cash used in operating activities	(1,356,272)	(839,244)
Cash flows from investing activities:		
Sale of short-term investments, net	3,118,962	8,366,614
Issuance of note receivable - related parties	(1,490,000)	-
Investments in water, water systems, and land	(2,989,567)	(6,397,763)
Purchase of property and equipment	(271,146)	(77,242)
Net cash (used in) provided by investing activities	(1,631,751)	1,891,609
Cash flows from financing activities:		
Proceeds from note receivable - related parties	215,504	-
Proceeds from the issuance of stock	75,000	-
Payments to contingent liability holders	(2,152)	(2,102)
Net cash provided by (used in) financing activities	288,352	(2,102)
Net change in cash and cash equivalents	(2,699,671)	1,050,263
Cash and cash equivalents – beginning of period	5,575,823	4,697,288
Cash and cash equivalents – end of period	$ 2,876,152	$ 5,747,551
SUPPLEMMENTAL DISCLOSURE OF NON-CASH ACTIVITIES		
Investment in water assets through accounts payable	$ -	$ 210,889
Transfer of prepaid asset to other asset	$ 89,609	$ -
Transfer of land and mineral interest to inventory	$ 1,691,989	$ -

See accompanying Notes to Consolidated Financial Statements

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NOTE 1 – PRESENTATION OF INTERIM INFORMATION

The May 31, 2018 consolidated balance sheet, the consolidated statements of operations and comprehensive income (loss) for the three and nine months ended May 31, 2018 and 2017, the consolidated statement of shareholders' equity for the nine months ended May 31, 2018, and the consolidated statements of cash flows for the nine months ended May 31, 2018 and 2017 have been prepared by Pure Cycle Corporation (the "Company") and have not been audited. The unaudited consolidated financial statements include all adjustments that are, in the opinion of management, necessary to present fairly the financial position, results of operations and cash flows at May 31, 2018, and for all periods presented. As described in Revenue Recognition and Recently Issued Accounting Pronouncements below, the Company early adopted Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606), using the modified retrospective method.

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 consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2017 (the "2017 Annual Report") filed with the Securities and Exchange Commission (the "SEC") on November 15, 2017. The results of operations for interim periods presented are not necessarily indicative of the operating results for the full fiscal year. The August 31, 2017 balance sheet was derived from the Company's audited consolidated financial statements.

Use of Estimates

The preparation of consolidated financial statements in accordance 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 consolidated 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 reputable financial institution. At various times during the three months ended May 31, 2018, the Company's main operating account exceeded federally insured limits. The Company has never suffered a loss due to such excess balance.

Inventories

Inventories primarily include land held for development and sale. Inventories are stated at cost, less reimbursements. Capitalized lot development costs at Sky Ranch are costs incurred to construct lots at Sky Ranch that meet the Company's capitalization criteria for improvements to a lot and are capitalized as incurred, including interest. The Company capitalizes certain legal, engineering, design, permitting, land acquisition, and construction costs related to the development of lots at Sky Ranch. We use the specific identification method for purposes of accumulating land development costs and allocate costs to each lot to determine the cost basis for each lot sale. We will record all land cost of sales when a lot is closed on a lot-by-lot basis.

Investments

Management determines the appropriate classification of its investments in certificates of deposit and debt and equity securities at the time of purchase and re-evaluates such determinations each reporting period.

Certificates of deposit and debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. The Company has $190,000 of investments classified as held-to-maturity at May 31, 2018, which represent certificates of deposit with a maturity date after May 31, 2019.

Securities that the Company does not have the positive intent or ability to hold to maturity, including certificates of deposit, debt securities and any investments in equity securities, are classified as available-for-sale. Securities classified as available-for-sale are marked-to-market at each reporting period. Changes in value of such securities are recorded as a component of Accumulated other comprehensive income (loss). The cost of securities sold is based on the specific identification method. The Company's certificates of deposit and treasury securities mature at various dates through March 2019.

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Concentration of Credit Risk and Fair Value

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents and investments. From time to time, the Company places its cash in money market instruments, certificates of deposit and U.S. government treasury obligations. To date, the Company has not experienced significant losses on any of these investments.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value.

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 amounts of cash and cash equivalents approximate fair value.

Trade Accounts Receivable – The Company records accounts receivable net of allowances for uncollectible accounts.

Investments – The carrying amounts of investments approximate fair value. Investments are described further in Note 2 – Fair Value Measurements.

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

Long-Term Financial Liabilities – The Comprehensive Amendment Agreement No. 1 (the "CAA") is comprised of a recorded balance sheet and an off-balance sheet or "contingent" obligation associated with the Company's acquisition of its "Rangeview Water Supply" (defined in Note 4 – Water and Land Assets in Part II, Item 8 of the 2017 Annual Report). The amount payable is a fixed amount but is repayable only upon the sale of "Export Water" (defined in Note 4 – Water and Land Assets in Part II, Item 8 of the 2017 Annual Report). Because of the uncertainty of the sale of Export Water, the Company has determined that the contingent portion of the CAA does not have a determinable fair value. The CAA is described further in Note 4 – Long-Term Obligations and Operating Lease – Participating Interests in Export Water Supply.

Notes Receivable – Related Parties – The market value of the notes receivable – related parties from Rangeview Metropolitan District (the "Rangeview District"), Sky Ranch Metropolitan District No. 5, and the Sky Ranch Community Authority Board, an entity formed by Sky Ranch Metropolitan District Nos. 1 and 5 (the "CAB"), as described further in Note 6 – Related Party Transactions, are not practical to estimate due to the related party nature of the underlying transactions.

The note receivable – related parties balance primarily relates to the Company funding certain costs related to the development of public improvements, such as drainage improvements, storm water improvements, roadways, curb and gutter improvements, parks and open spaces. These costs are incurred by the CAB and funds for these improvements are advanced by the Company to the CAB under a Project Funding and Reimbursement Agreement which acts as a loan of funds from the Company to the CAB and earns interest at the rate of 6%. As homes are sold, the Sky Ranch Metropolitan Districts will develop assessed value in the community and levy mills against the assessed value to generate property tax revenues to the Sky Ranch Metropolitan Districts that can be used to fund the CAB to repay the Company's loan advances. These loan advances are recorded as a note receivable and accrue interest from the time of the loan.

Notes Receivable – PCY Holdings, LLC, a wholly owned subsidiary of the Company ("PCY Holdings") entered into a Twelfth Amendment to contract for Purchase and Sale of Real Estate (the "Twelfth Amendment") with each of two builders purchasing its lots for sale (each, a "Builder"). The Company's finished lot improvements obligation for each lot

does not include any over-excavation on the property. Each Builder is solely responsible to perform the over-excavation and is granted the right (pursuant to a license agreement to be provided by PCY Holdings) to enter the lots for the purpose of performing the over-excavation. In order to facilitate each Builder's ability to enter into a over-excavation contract (the "Over-excavation Contract") with a grading contractor (the "Grading Contractor"), and solely as an accommodation to each Builder, PCY Holdings agreed to make progress payments to the Grading Contractor under the terms of an Over-excavation Contract as such payments become due and payable for work performed the Over-excavation Contract through and until the first to occur of the following: (i) the date of the first closing of the purchase and sale of the applicable Phase 1 lots (the "Takedown 1 Closing Date"), (ii) the termination of the applicable Contract for Purchase and Sale of Real Estate, or (iii) the total amount paid by PCY Holdings as progress payments equals $350,000 or $136,700, as specified in each Twelfth Amendment (the "Payment Cap"). After the applicable Payment Cap has been met or after the occurrence of the Takedown 1 Closing Date, whichever first occurs, each Builder will be solely responsible for making all progress payments to the Grading Contractor that become due and payable on or after such date, and PCY Holdings will be relieved of any obligation under the Twelfth Amendment to make any further payment for the benefit of such Builder under the Over-excavation Contract. At the first closing of the purchase and sale of the applicable Phase 1 lots (the "First Closing"), and in addition to that portion of the purchase price for each lot payable by each Builder at the First Closing, each Builder must as a condition to closing reimburse PCY Holdings for all progress payments and any other payments made by PCY Holdings pursuant to the Over-excavation Contract, plus simple interest at 6% per annum on each payment from the date paid by PCY Holdings until the earlier of (i) the date that is 60 days after the date of the first progress payment made by PCY Holdings and (ii) the Takedown 1 Closing Date (collectively, the "Over-excavation Payment). If PCY Holdings does not satisfy its closing obligation for the First Closing, the Builder will not be obligated to pay the Over-excavation Payment and PCY Holdings will be obligated to reimburse the Grading Contractor for any amounts the Builder owes for work performed prior to termination that was not previously paid by PCY Holdings pursuant to the Twelfth Amendment.

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The market value of the notes receivable approximate fair value due to the relatively short period to maturity for these instruments and the prevailing rates approximate market rates.

Off-Balance Sheet Instruments – The Company's off-balance sheet instruments consist entirely of the contingent portion of the CAA. Because repayment of this portion of the CAA is contingent on the sale of Export Water, which is not reasonably estimable, the Company has determined that the contingent portion of the CAA does not have a determinable fair value. See further discussion in Note 4 – Long-Term Obligations and Operating Lease – Participating Interests in Export Water Supply.

Revenue Recognition

The Company disaggregates revenue by major product line as reported on the consolidated statements of operations and comprehensive income (loss).

Comparative results for the three and nine months ended May 31, 2018 and 2017 differ due to the adoption by the Company of ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), as of September 1, 2017. Prior to the adoption of ASU 2014 09, proceeds from tap fees and construction fees were deferred upon receipt and recognized in income either upon completion of construction of infrastructure or ratably over time, depending on whether the Company owned the infrastructure constructed with the proceeds or a customer owned the infrastructure constructed with the proceeds. Tap and construction fees derived from agreements in which the Company would not own the assets constructed with the fees were recognized as revenue using the percentage-of-completion method. Tap and construction fees derived from agreements for which the Company would own the infrastructure were recognized as revenues ratably over the estimated accounting service life of the facilities constructed, starting at completion of construction, which could be in excess of 30 years.

As described in Recently Issued Accounting Pronouncements below, the Company has completed its review of the adoption of ASU 2014 09 and the related impact on each of the Company's revenue streams (water and wastewater usage fees, consulting fees, tap fees, special facility or construction fees, lot sales and oil and gas revenues). Upon completion of the Company's evaluation of the standard, the Company determined to early adopt the new revenue recognition standard beginning September 1, 2017, in accordance with the transition provisions in ASU 2014 09, utilizing the modified retrospective method. The Company's analysis concluded that the adoption did have a material impact on the 2018 financial statements.

The Company recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of accumulated deficit. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. The most significant impact of the standard relates to the Company' accounting for tap fees and special facility or construction fees, which revenues are expected to be recognized in earlier periods under the new revenue standard. Revenue recognition related to the Company's water and wastewater usage fees, consulting fees and oil and gas royalty or lease payments will remain substantially unchanged as a result of the adoption of ASU 2014-09.

Wholesale Water and Wastewater Fees – Monthly wholesale water usage charges are assessed to the Company's customers based on actual metered usage each month plus a base monthly service fee. The Company recognizes wholesale water usage revenues upon delivering water to its customers or its governmental customer's end-use customers, as applicable. Sales of Export Water are invoiced directly by the Company, and revenues recognized by the Company are shown gross of royalties to the State of Colorado Board of Land Commissioners (the "Land Board"). Sales of water on the "Lowry Range" (described in Note 4 – Water and Land Assets under "Rangeview Water Supply and Water System" of the 2017 Annual Report) are invoiced directly by the Rangeview District, and the Rangeview District pays a percentage of such collections to the Company. Water revenues recognized from sales on the Lowry Range are recognized based on the amounts billed to the Rangeview District. The Company recognized $1,162,600 and $47,700

of metered water usage revenues during the three months ended May 31, 2018 and 2017, respectively. The Company recognized $2,889,000 and $379,500 of metered water usage revenues during the nine months ended May 31, 2018 and 2017, respectively.

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The Company recognizes wastewater treatment fees monthly based on usage. The monthly wastewater treatment fees are recognized based on the amounts billed to the Rangeview District. The Company recognized $11,700 and $7,000 of wastewater treatment fees during the three months ended May 31, 2018 and 2017, respectively. The Company recognized $32,200 and $30,500 of wastewater treatment fees during the nine months ended May 31, 2018 and 2017, respectively. Costs of delivering water and providing wastewater services to customers are recognized as incurred.

Tap Fees – The Company has various water and wastewater service agreements, components of which may include tap fees. A tap fee constitutes a right to connect to the Company's wholesale water and wastewater systems through a service line to a residential or commercial building or property, and once granted, the customer may make a physical tap into the wholesale line(s) to connect its property for water and/or wastewater service. Once connected to the water and/or wastewater systems, the customer has live service to receive metered water deliveries from our system and send wastewater into our system. Thus, the customer has full control of the connection right as it has the ability to obtain all of the benefits from this right. As such, management has determined that tap fees are separate and distinct performance obligations.

The Company recognizes water tap fees as revenue at the time the Company grants a right for the customer to tap into the water service line to obtain water service. The Company recognized $0 and $47,000 of water tap fee revenues during the three months ended May 31, 2018 and 2017, respectively. The Company recognized $49,900 and $54,100 of water tap fee revenues during the nine months ended May 31, 2018 and 2017, respectively. The water tap fees recognized are based on the amounts billed to the Rangeview District and any amounts paid to third parties pursuant to the CAA as further described in Note 4 – Long-Term Obligations and Operating Lease below.

The Company recognizes construction fees, including fees received to construct "Special Facilities" (defined in Part I, Item 1 of the 2017 Annual Report), on a percentage-of-completion basis as the construction is completed. Special Facilities are facilities that enable water to be delivered to a single customer. Management has determined that Special Facilities are separate and distinct performance obligations. The Company recognized $10,400 and $31,100 of Special Facilities funding as revenue under its previous revenue recognition ASU No. 2009-13, Revenue Recognition (Topic 605) standard during the three and nine months ended May 31, 2017, respectively. No Special Facilities revenue has been recognized during the three or nine months ended May 31, 2018. The 2017 amounts are the ratable portion of the Special Facilities funding, or construction fees, received from water agreements as more fully described in Note 2 – Summary of Significant Accounting Policies in Part II, Item 8 of the 2017 Annual Report.

As of May 31, 2018, and August 31, 2017, the Company has deferred recognition of approximately $0 and $1,055,500, respectively, of water tap and construction fee revenue.

Consulting Fees – Consulting fees are fees the Company receives, typically on a monthly basis, from municipalities and area water providers along the I-70 corridor, for contract operations services. Consulting fees are recognized monthly based on a flat monthly fee plus charges for additional work performed. The Company recognized $37,900 and $22,000 of consulting fees during the three months ended May 31, 2018 and 2017, respectively. The Company recognized $95,900 and $75,000 of consulting fees during the nine months ended May 31, 2018 and 2017, respectively.

Lot Sales – The Company owns 931 acres of land zoned as a Master Planned Community along the I-70 corridor east of Denver, Colorado, known as Sky Ranch. We have entered into purchase and sale agreements with three separate home builders pursuant to which the Company agreed to sell, and each builder agreed to purchase, residential lots at the property. The Company began construction of lots on March 1, 2018 and will segment its reporting of the activity relating to the costs and revenues from the construction and sale of lots at Sky Ranch. The Company did not recognize any lot sales during the nine months ended May 31, 2018.

The Company sells lots at Sky Ranch pursuant to distinct agreements with each builder. These agreements follow one of two formats. One format is the sale of a finished lot, whereby the purchaser pays for a ready-to-build finished lot and payment is a lump-sum payment upon completion of the finished lot. The Company will recognize revenues at the point in time at the closing of the sale of an individual finished lot as the transaction cycle will be complete and the Company will have no further obligations for the lot.

The Company's second format is the sale of finished lots pursuant to a development agreement with builders, whereby the Company will recognize revenues in stages that include (i) payment upon the delivery of platted lots (which requires the Company to deliver deeded title to individual lots), (ii) a second payment at the completion of certain infrastructure milestones, and (iii) final payment upon the delivery of the finished lot. The Company has determined that the development agreement format has a single performance obligation and thus will defer the receipt of revenues from the first two milestones and recognize the full revenue from the sale of the lot at a point in time upon delivery of the third milestone once the Company completes all contractual commitments concurrent with the delivery of the finished lot.

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Royalty and Other Obligations

Revenues from the sale of Export Water are shown gross of royalties payable to the Land Board. Revenues from the sale of water on the “Lowry Range” (described in Note 4 – Water and Land Assets in Part II, Item 8 of the 2017 Annual Report) are invoiced directly by the Rangeview District, and a percentage of such collections are then paid to the Company by the Rangeview District. Water revenue from such sales are shown net of royalties paid to the Land Board and amounts retained by the Rangeview District.

Oil and Gas Lease Payments

As further described in Note 2 – Summary of Significant Accounting Policies in Part II, Item 8 of the 2017 Annual Report, in March 2011, the Company entered into a Paid-Up Oil and Gas Lease and a Surface Use and Damage Agreement that were subsequently purchased by a wholly owned subsidiary of ConocoPhillips Company. Two wells were drilled within the Company’s mineral interest and placed into service and began producing oil and gas and accruing royalties to the Company. During the three months ended May 31, 2018 and 2017, the Company received $61,100 and $24,900 net of taxes, respectively, in royalties attributable to these two wells. During the nine months ended May 31, 2018 and 2017, the Company received $152,700 and $164,300 net of taxes, respectively, in royalties attributable to these two wells. The Company classifies income from oil and gas lease and royalty payments as Other income in the statement of operations and comprehensive income (loss) as the Company does not consider these arrangements to be an operating business activity.

On October 5, 2017, the Company entered into a Paid-Up Oil and Gas Lease with Bison Oil and Gas, LLP for the purpose of exploring for, developing, producing, and marketing oil and gas on the 40 acres of mineral estate the Company owns adjacent to the Lowry Range (the “Bison Lease”). Pursuant to the Bison Lease, the Company received an up-front payment of $167,200, which will be recognized as income on a straight-line basis over three years (the term of the Bison Lease). The Company recognized lease income of $13,900 and $37,200 during the three and nine months ended May 31, 2018, respectively, related to the up-front payment received pursuant to the Bison Lease. As of May 31, 2018, the Company has deferred recognition of $130,000 of income related to the Bison Lease which will be recognized into income ratably through September 2020.

Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the eventual use of the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

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

Costs to construct water and wastewater systems that meet the Company’s capitalization criteria are capitalized as incurred, including interest, and depreciated on a straight-line basis over their estimated useful lives of up to 30 years. The Company capitalizes design and construction costs related to construction activities, and it capitalizes certain legal, engineering and permitting costs relating to the adjudication and improvement of its water assets. The Company depletes its groundwater assets that are being utilized on the basis of units produced (i.e., thousands of gallons sold) divided by the total volume of water adjudicated in the water decrees.

Share-Based Compensation

The Company maintains a stock option plan for the benefit of its employees and non-employee directors. The Company records share-based compensation costs as expense over the applicable vesting period of the stock award using the straight-line method. The compensation costs to be expensed are measured at the grant date based on the fair value of the award. The Company has adopted the alternative transition method for calculating the tax effects of share-based compensation, which allows for a simplified method of calculating the tax effects of employee share-based compensation. Because the Company has a full valuation allowance on its deferred tax assets, the granting and exercise of stock options has no impact on the income tax provisions. The Company recognized $83,600 and $63,500 of share-based compensation expense during the three months ended May 31, 2018 and 2017, respectively, and $241,200 and $168,000 of share-based compensation expense during the nine months ended May 31, 2018 and 2017, respectively.

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Income Taxes

The Company uses a “more-likely-than-not” threshold for the recognition and de-recognition of tax positions, including any potential interest and penalties relating to tax positions taken by the Company. The Company did not have any significant unrecognized tax benefits as of May 31, 2018.

Due to the complexities involved in accounting for the recently enacted Tax Cuts and Jobs Act (the “Tax Act”), the SEC’s Staff Accounting Bulletin No. 118 (“SAB 118”) requires that the Company include in its financial statements the reasonable estimate of the impact of the Tax Act on earnings to the extent such estimate has been determined. Pursuant to SAB 118, the Company is allowed a measurement period of up to one year after the enactment date of the Tax Act to finalize the recording of the related tax impacts. The final impact on the Company from the Tax Act may differ from the aforementioned estimates due to the complexity of calculating and supporting with primary evidence, changes in interpretations of the Tax Act, future legislative action to address questions that arise because of the Tax Act, changes in accounting standards for income taxes or related interpretations in response to the Tax Act, or any updates or changes to estimates the Company has utilized to calculate the reasonable estimate. The Company’s deferred tax asset and full valuation allowance was decreased by approximately $1 million as a result of the decreased corporate tax rate. The Company will continue to evaluate the impact of the Tax Act and will record any resulting tax adjustments during 2018.

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 year 2014 through fiscal year 2017. The Company does not believe there will be any material changes in its unrecognized tax positions over the next 12 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, 2018, 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 months ended May 31, 2018 or 2017.

Discontinued Operations

In August 2015, the Company sold substantially all of its Arkansas River water and land properties. Pursuant to the terms of the purchase and sale agreement, the Company continued to manage and receive the lease income associated with such properties until December 31, 2015. The operating results and the assets and liabilities of the discontinued operations, which formerly comprised the agricultural segment, are presented separately in the Company’s consolidated financial statements. Summarized financial information for the discontinued agricultural business is shown below. Prior period balances have been reclassified to present the operations of the agricultural business as a discontinued operation.

Discontinued Operations Income Statement

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2018	2017	2018	2017
Farm revenues	$ 1,000	$ 600	$ 2,400	$ 6,300
Farm expenses	-	-	-	-
Gross profit	1,000	600	2,400	6,300
General and administrative expenses	-	11,900	-	48,300
Operating profit (loss)	1,000	(11,300)	2,400	(42,000)
Finance charges	-	-	-	9,400
Income (loss) from discontinued operations	$ 1,000	$ (11,300)	$ 2,400	$ (32,600)

The Company anticipates continued expenses through calendar 2018 related to the discontinued operations. The Company will continue to incur expenses (including property taxes) related to the remaining agricultural land the Company continues to own and for the purpose of collecting outstanding receivables.

The individual assets and liabilities of the discontinued agricultural business are combined in the captions “Assets of discontinued operations held for sale” and “Liabilities of discontinued operations” in the consolidated balance sheet. The carrying amounts of the major classes of assets and liabilities included as part of the discontinued business are presented in the following table:

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Discontinued Operations Balance Sheet

	May 31, 2018	August 31, 2017
Assets:		
Trade accounts receivable	$ 86,800	$ 110,700
Land held for sale (*)	450,600	450,600
Total assets	$ 537,400	$ 561,300
Liabilities:		
Accrued liabilities	$ 5,600	$ 11,200
Total liabilities	$ 5,600	$ 11,200

(*) Land Held for Sale. During the fiscal quarter ended November 30, 2015, the Company purchased three farms totaling 700 acres for approximately $450,600. The farms were acquired in order to correct dry-up covenant issues related to water only farms in order to obtain the release of the escrow funds related to the Company's farm sale to Arkansas River Farms, LLC. The Company intends to sell the farms in due course and has classified the farms as long-term assets.

Income (Loss) per Common Share

Income (loss) per common share is computed by dividing net income (loss) by the weighted average number of shares outstanding during each period. Common stock options and warrants aggregating 535,500 and 470,600 common share equivalents were outstanding as of May 31, 2018 and 2017, respectively, and have been included in the calculation of diluted net income per common share but excluded from the calculation of loss per common share as their effect is anti-dilutive.

Recently Issued Accounting Pronouncements

The Company continually assesses any new accounting pronouncements to determine their applicability. When 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 consolidated financial statements and ensure that there are proper controls in place to ascertain that the Company's consolidated financial statements properly reflect the change. New pronouncements assessed by the Company recently are discussed below:

In February 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-02, Leases (Topic 842). ASU 2016 02 provides guidance on the recognition, measurement, presentation, and disclosure of leases. The new standard supersedes the present GAAP standard on leases and requires substantially all leases to be reported on the balance sheet as right-of-use assets and lease obligations. This standard is effective for fiscal years beginning after December 15, 2018. The Company is currently assessing the impact of ASU 2016-02.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Recognition and Measurement of Financial Assets and Financial Liabilities (Topic 825). ASU No. 2016-01 revises the classification and measurement of investments in certain equity investments and the presentation of certain fair value changes for certain financial liabilities measured at fair value. ASU No. 2016-01 requires the change in fair value of many equity investments to be recognized in net income. This standard is effective for interim and annual periods beginning after December 15, 2017 with early adoption permitted. The Company adopted ASU No. 2016-01 in its third quarter of 2018 utilizing the modified retrospective transition method. Based on the composition of the Company's investment portfolio, the adoption of ASU No. 2016-01 did not have a material impact on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. ASU 2014-15 describes how an entity's management should assess, considering both quantitative and qualitative factors, whether there are conditions and events that raise substantial doubt about an entity's ability to continue as a going concern within one year after the date that the financial statements are issued, which represents a change from the existing literature that requires consideration about an entity's ability to continue as a going concern within one year after the balance sheet date. The standard was effective for the Company on September 1, 2017. The adoption of ASU 2014-15 did not have a material impact on the Company's financial statements.

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In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), that requires recognition of revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. The FASB has also issued several updates to ASU 2014-09. The standard supersedes ASU No. 2009-13, Revenue Recognition (Topic 605) ("ASC 605"), and requires the use of more estimates and judgments than do the present standards. It also requires additional disclosures. The Company has completed its review of the adoption of ASU 2014 09 and the related impact on each of the Company's revenue streams (water and wastewater usage fees, consulting fees, tap fees, special facility or construction fees, lot sales and oil and gas revenues). Upon completion of the Company's evaluation of the standard, the Company determined to early adopt the new revenue recognition standard beginning September 1, 2017, in accordance with the transition provisions in ASU 2014 09, utilizing the modified retrospective method. The Company concluded that the adoption did have a material impact on the Company's financial statements.

The Company recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of accumulated deficit. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.

The cumulative effect of the changes made to the Company's consolidated September 1, 2017 balance sheet for the adoption of ASU 2014-09 were as follows:

	Balance at August 31, 2017	Adjustments Due to ASU 2014-09	Balance at September 1, 2017
Balance Sheet			
Assets			
Deferred tax assets (Deferred revenue)	$ 316,400	$ (316,400)	$ -
Deferred tax assets - valuation allowance (Deferred revenue)	(316,400)	316,400	-
Liabilities			
Deferred revenues, current	$ 55,800	$ (55,800)	$ -
Deferred revenues, less current portion	999,249	(999,249)	-
Equity			
Accumulated deficit	$ (103,993,900)	$ 1,055,049	$ (102,938,851)

In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on the Company's consolidated statements of operations and comprehensive income (loss) and balance sheet was as follows:

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For the Nine Months Ended May 31, 2018

	As Reported	Amounts that would have been reported under ASC 605	Effect of Change Higher/(Lower)
Income statement			
Revenues			
Special facility fees	$ -	$ 31,131	$ (31,131)
Water tap fees	49,948	60,669	(10,721)
Net income	$ 58,153	$ 100,004	$ (41,852)

As of May 31, 2018

	As Reported	Amounts that would have been reported under ASC 605 [1]	Effect of Change Higher/(Lower)
Balance Sheet			
Liabilities			
Deferred revenues, current	$-	$ 55,800	$ (55,800)
Deferred revenues, less current portion	-	957,836	(957,836)
Deferred oil and gas lease payment, current [1]	55,733	55,733	-
Deferred oil and gas lease payment, less current portion	74,311	74,311	-
Equity			
Accumulated deficit	$(102,880,698)	$ (103,893,896)	$ 1,013,198

(1) Inclusive of the Bison Lease deferred oil and gas lease payment and water tap and construction fee deferred revenues as described in the 2017 Annual Report.

Revenue recognition related to the Company’s water and wastewater usage, consulting revenues and oil and gas revenues will remain substantially unchanged as a result of the adoption of ASU 2014-09. The most significant impact of the standard relates to the Company’s accounting for water and wastewater tap fees and special facility/construction fees, which revenues will be recognized in earlier periods when performance obligations are complete under the new revenue standard.

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 where within the fair value hierarchy the measurement falls.

Level 1 — Valuations for assets and liabilities traded in active exchange markets, such as the NASDAQ Stock Market. The Company had no Level 1 assets or liabilities as of May 31, 2018 or August 31, 2017.

Level 2 — Valuations for assets and liabilities obtained from readily available pricing sources via independent providers for market transactions involving similar assets or liabilities. The Company had 16 and 56 Level 2 assets as of May 31, 2018 and August 31, 2017, respectively, which consist of certificates of deposit, U.S. Treasury bills and U.S. Treasury notes.

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, the contingent portion of the CAA, as of May 31, 2018 and August 31, 2017. The Company has determined that the contingent portion of the CAA does not have a determinable fair value (see Note 4 – Long-Term Obligations and Operating Lease).

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

Level 2 Asset – Available for Sale Securities. The Company's available for sale securities are the Company's only financial asset measured at fair value on a recurring basis. The fair value of the available for sale securities is based on the values reported by the financial institutions where the funds are held. These securities include only federally insured certificates of deposit and U.S. Treasury bills and notes.

The Company's non-financial assets measured at fair value on a non-recurring basis consist entirely of its investments in water and water systems, land held for sale, and other long-lived assets. See Note 3 – Water and Land Assets below.

The following table provides information on the assets and liabilities measured at fair value on a recurring basis as of May 31, 2018:

			Fair Value Measurement Using:			
	Fair Value	Cost / Other Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Accumulated Unrealized Gains and (Losses)
Certificates of deposit	$1,248,781	$1,250,000	$ -	$ 1,248,781	$ -	$ (1,219)
U.S. treasuries	15,757,133	15,695,690	-	15,757,133	-	61,443
Total	$17,005,914	$16,945,690	$ -	$ 17,005,914	$ -	$ 60,224

The following table provides information on the assets and liabilities measured at fair value on a recurring basis as of August 31, 2017:

			Fair Value Measurement Using:			
	Fair Value	Cost / Other Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Accumulated Unrealized Gains and (Losses)
Certificates of deposit	$12,673,700	$12,694,500	$ -	$ 12,673,700	$ -	$ (20,800)
U.S. treasuries	7,381,700	7,372,000	-	7,381,700	-	9,700
Total	$20,055,400	$20,066,500	$ -	$ 20,055,400	$ -	$ (11,100)

The Company also holds a certificate of deposit that is not carried at fair value on the consolidated balance sheets and is classified as a held-to-maturity security. As of May 31, 2018, the carrying amount of held-to-maturity securities was $189,800. As of August 31, 2017, the carrying amount of held-to-maturity securities was $188,000.

NOTE 3 – WATER AND LAND ASSETS

The Company’s water rights and current water and wastewater service agreements are more fully described in Note 4 – Water and Land Assets in Part II, Item 8 of the 2017 Annual Report. There have been no significant changes to the Company’s water rights or water and wastewater service agreements during the nine months ended May 31, 2018.

Investment in Water and Water Systems

The Company’s Investments in Water and Water Systems consist of the following costs and accumulated depreciation and depletion at May 31, 2018 and August 31, 2017:

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	May 31, 2018		August 31, 2017	
	Costs	Accumulated Depreciation and Depletion	Costs	Accumulated Depreciation and Depletion
Rangeview water supply	$14,805,500	$ (12,100)	$14,529,600	$ (10,600)
Sky Ranch water rights and other costs	7,342,400	(523,100)	6,725,000	(436,300)
Fairgrounds water and water system	2,899,900	(1,040,900)	2,899,900	(974,800)
Rangeview water system	1,652,400	(247,700)	1,639,000	(207,000)
WISE partnership	3,114,100	-	3,114,100	-
Water supply – other	1,177,700	(486,700)	944,800	(401,300)
Wild Pointe service rights	1,631,800	(251,400)	1,631,700	(213,000)
Sky Ranch pipeline	4,697,800	(156,600)	4,700,000	