PURE CYCLE CORP
Form 10-Q
January 09, 2008

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

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended: November 30, 2007

o **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 small business issuer as specified in its charter)

Delaware	**84-0705083**
(State of incorporation)	(I.R.S. Employer Identification Number)
8451 Delaware St., Thornton, CO	**80260**
(Address of principal executive offices)	(Zip Code)

(303) 292 3456

Registrant s telephone number

N/A

(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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of January 4, 2008:

Common stock, 1/3 of $.01 par value	20,206,566
(Class)	(Number of Shares)

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PURE CYCLE CORPORATION
BALANCE SHEETS

ASSETS:	November 30, 2007 (unaudited)	August 31, 2007
Current assets:		
Cash and cash equivalents	$ 6,288,271	$ 6,095,075
Marketable securities	300,188	799,802
Trade accounts receivable	52,605	70,217
Interest receivable	20,907	11,585
Prepaid expenses	176,721	246,968
Current portion of construction proceeds receivable	64,783	64,783
Total current assets	6,903,475	7,288,430
Investments in water and water systems, net	103,199,205	103,248,427
Construction proceeds receivable, less current portion, including $240,075 expected to be paid with water rights	744,618	792,719
Note receivable Rangeview Metropolitan District, including accrued interest	481,403	475,734
Assets held for sale	77,940	77,940
Investment in Well Enhancement and Recovery Systems, LLC	3,812	4,431
Property and equipment, net	10,583	4,210
Total assets	$ 111,421,036	$ 111,891,891
LIABILITIES:		
Current liabilities:		
Accounts payable	$ 62,524	$ 15,056
Accrued liabilities	97,201	85,919
Deferred revenues	55,800	55,800
Current debt related party		26,542
Total current liabilities	215,525	183,317
Deferred revenues, less current portion	1,543,760	1,557,711
Participating Interests in Export Water Supply	1,219,131	2,851,037
Tap Participation Fee payable to HP A&M, net of discount of $57.9 million and $55.1 million	50,506,000	49,455,000
Total liabilities	53,484,416	54,047,065
Commitments and Contingencies		
STOCKHOLDERS EQUITY:		
Preferred stock:		

Par value $.001 per share, 25 million shares authorized;		
Series B 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;		
20,206,566 and 19,995,338 shares outstanding	68,216	67,512
Additional paid-in capital	93,636,752	91,650,897
Treasury stock, at cost, 256,800 and 256,800 shares of common stock	(1,979,447)	(1,979,447)
Accumulated comprehensive income (loss)	7,400	7,168
Accumulated deficit	(33,796,734)	(31,901,737)
Total stockholders equity	57,936,620	57,844,826
Total liabilities and stockholders equity	$ 111,421,036	$ 111,891,891

See Accompanying Notes to Financial Statements

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PURE CYCLE CORPORATION
STATEMENTS OF OPERATIONS
(unaudited)

	Three Months Ended November 30, 2007	Three Months Ended November 30, 2006
Revenues:		
Metered water usage	$ 39,023	$ 35,005
Wastewater treatment fees	16,744	14,752
Special facility funding	10,377	10,377
Water tap fees	3,574	3,574
Total revenues	69,718	63,708
Expenses:		
Cost of revenues:		
Water delivery costs	(15,195)	(13,689)
Wastewater treatment costs	(4,181)	(5,909)
Depletion and depreciation	(22,031)	(21,829)
Total cost of revenues	(41,407)	(41,427)
Gross margin	28,311	22,281
General and administrative expenses	(651,556)	(443,536)
Depreciation	(73,526)	(68,624)
Operating loss	(696,771)	(489,879)
Other income (expense):		
Interest income	126,960	44,603
Gain on sale of marketable securities	156	1,064
Share of losses of Well Enhancement and Recovery Systems, LLC	(619)	
Loss on extinguishment of contingent obligations	(273,723)	
Interest expense imputed on the Tap Participation Fees payable to HP A&M	(1,051,000)	(1,141,000)
Net loss	$ (1,894,997)	$ (1,585,212)
Net loss per common share basic and diluted	$ (.09)	$ (.09)
Weighted average common shares outstanding basic and diluted	20,136,157	18,353,443

See Accompanying Notes to Financial Statements

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PURE CYCLE CORPORATION
STATEMENTS OF CASH FLOWS
(unaudited)

	Three Months Ended November 30,	
	2007	2006
Cash flows from operating activities:		
Net loss	$ (1,894,997)	$ (1,585,212)
Adjustments to reconcile net loss to net cash used by operating activities:		
Stock compensation expense	81,282	78,236
Depreciation, depletion and other non-cash items	96,447	91,158
Imputed interest expensed on Tap Participation Fees payable to HP A&M	1,051,000	1,141,000
Interest added to construction proceeds receivable	(6,697)	(12,831)
Interest added to note receivable Rangeview Metropolitan District	(5,669)	(5,860)
Gain on sale of marketable securities	(156)	(1,064)
Share of losses of Well Enhancement and Recovery Systems, LLC	619	
Loss on extinguishment of contingent obligations	273,723	
Changes in operating assets and liabilities:		
Trade accounts receivable	17,612	19,633
Construction proceeds receivable	54,798	28,665
Interest receivable and prepaid expenses	60,925	(38,987)
Accounts payable and accrued liabilities	58,750	(134,495)
Deferred revenues	(13,951)	(13,951)
Net cash used by operating activities	(226,314)	(433,708)
Cash flows from investing activities:		
Investments in water and water systems	(45,161)	(4,000)
Capitalized acquisition costs		(35,800)
Sales and maturities of marketable securities	499,770	199,960
Purchase of marketable securities		
Purchase of property and equipment	(7,547)	
Net cash provided by investing activities	447,062	160,160
Cash flows from financing activities:		
Payments to Participating Interests in Export Water Supply holders	(1,010)	(1,083)
Payments on debt	(26,542)	
Net cash used by financing activities	(27,552)	(1,083)
Net change in cash and cash equivalents	193,196	(274,631)
Cash and cash equivalents beginning of period	6,095,075	374,069
Cash and cash equivalents end of period	$ 6,288,271	$ 99,438

See Accompanying Notes to Financial Statements

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NOTE 1   PRESENTATION OF INTERIM INFORMATION

The balance sheet as of November 30, 2007, and the statements of operations and cash flows for the three months ended November 30, 2007 and 2006, respectively, have been prepared by Pure Cycle Corporation (the   Company   ) and have not been audited. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary to present fairly the financial position, results of operations and cash flows at November 30, 2007 and for all periods presented have been appropriately made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP   ) have been condensed or omitted. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company   s 2007 Annual Report on Form 10-K. The results of operations for interim periods presented are not necessarily indicative of the operating results for the full year.

The August 31, 2007 balance sheet was derived from the Company   s audited financial statements.

Cash and Cash Equivalents. Cash and cash equivalents include all highly liquid debt and equity instruments with original maturities of three months or less. The Company   s cash equivalents are comprised of money market funds and investments in commercial paper. As of November 30, 2007, the Company has no investments in equity instruments.

Tap Participation Fee payable to HP A&M. The Tap Participation Fee payable to High Plains A&M (HP A&M   ), arose as a result of the Company   s acquisition of its Arkansas River Water rights and is described in greater detail in the Company   s 2007 Annual Report on Form 10-K. The $50.5 million estimated fair value of the Tap Participation Fee payable at November 30, 2007 (which includes imputed interest of approximately $5.7 million) was determined using a discounted cash flow analysis of the projected future payments to HP A&M. The Company determined this value by estimating new home development in the Company   s service area over an estimated development period. This was done by utilizing third party historical and projected housing and population growth data for the Denver, Colorado metropolitan area applied to an estimated development pattern supported by historical development patterns of certain master planned communities in the Denver, Colorado metropolitan area. This development pattern was then applied to future water tap fees that were calculated using historical water tap fees. Based on the housing market in the Denver metropolitan area, the Company updated its estimated tap sales schedule as it relates to the Tap Participation Fee estimate as of November 30, 2007. The effect of this change was an increase in the overall future estimated Tap Participation Fee of approximately $3.9 million (from approximately $104.6 million to approximately $108.5 million), a decrease in the imputed effective interest rate from 10% to approximately 8.6% and a decrease in the imputed interest expense for the three months ended November 30, 2007 of approximately $183,400 (approximately $702,000 for the fiscal year). Actual development may differ substantially from the estimated new home development in the Company   s service area, which may have a material effect on the estimated fair value of the Tap Participation Fee payable to HP A&M and such differences may have a material impact on the financial statements. The valuation of the Tap Participation Fee payable to HP A&M is a significant estimate based on available historic market information and estimated future market information. Many factors are necessary to estimate future market conditions, including but not limited to, supply and demand for new homes, population growth along the Front Range, cash flows, tap fee increases at the Company   s rate-based districts, and other market forces beyond the Company   s control.

The Company imputes interest expense on the unpaid Tap Participation Fee using an effective interest method over the estimated development period utilized in the valuation of the liability. The Company imputed interest of approximately $1.1 million related to the Tap Participation Fee during both the three month periods ended November 30, 2007 and 2006, respectively.

Royalty and other obligations. Revenues from the sale of Export Water are shown net of royalties payable to the State of Colorado Board of Land Commissioners (the   Land Board   ). Revenues from the sale of water on the Lowry Range Property are shown net of the royalties to the Land Board and the fees retained by the Rangeview Metropolitan District.

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Depletion and depreciation of water assets. Water supplies that are being utilized are depleted on the basis of units produced divided by the total volume of water adjudicated in the water decrees. Water systems are depreciated on a straight line basis over their estimated useful lives.

Recently Adopted Accounting Pronouncements. On September 1, 2007, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes a more-likely-than-not threshold for the recognition and de-recognition of tax positions, providing guidance on the accounting for interest and penalties relating to tax positions and requires that the cumulative effect of applying the provisions of FIN 48 shall be reported as an adjustment to the opening balance sheet of retained earnings or other appropriate components of equity or net assets in the statement of financial position. The Company did not have any significant unrecognized tax benefits and there was no material effect on its financial condition or results of operations as a result of implementing FIN 48.

The Company files income tax returns in the U.S. federal jurisdiction and the State of Colorado. The tax years that remain subject to examination are fiscal 2005 through fiscal 2007. The Company does not believe there will be any material changes in its unrecognized tax positions over the next twelve months.

The Company s policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the quarter.

Recently Issued Accounting Pronouncements. In December 2007, the FASB issued Statement of Financial Accounting Standard No. 141 (R), *Business Combinations* (SFAS 141 (R)),which becomes effective for fiscal periods beginning after December 15, 2008 (September 1, 2009 for the Company). SFAS No. 141 (R) requires all business combinations completed after the effective date to be accounted for by applying the acquisition method (previously referred to as the purchase method). Companies applying this method will have to identify the acquirer, determine the acquisition date and purchase price and recognize at their acquisition date fair values of the identifiable assets acquired, liabilities assumed, and any non-controlling interests in the acquiree. In the case of a bargain purchase the acquirer is required to reevaluate the measurements of the recognized assets and liabilities at the acquisition date and recognize a gain on that date if an excess remains. The Company does not expect the adoption of this statement to have a material impact on its financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB 51* (SFAS 160) which becomes effective for fiscal periods beginning after December 15, 2008 (September 1, 2009 for the Company). This statement amends ARB 51 to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. The statement requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. In addition this statement establishes a single method of accounting for changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation and requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. The Company does not expect the adoption of this statement to have a material impact on its financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 allows companies the choice to measure many financial instruments and certain other items at fair value. This gives a company the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 (September 1, 2008 for the Company). The Company is currently evaluating the impact of this standard on its financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement*, (FAS 157), which establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. FAS 157 is effective for fiscal years, and the interim periods within those fiscal years, beginning after November 15, 2007 (September 1, 2008 for the Company). The Company is currently evaluating the impact of this

standard on its financial statements.

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NOTE 2 MARKETABLE SECURITIES

Marketable Securities. Management determines the appropriate classification of its investments in debt and equity securities at the time of purchase and reevaluates such determinations each reporting period. 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 had no investments classified as held-to-maturity at November 30, 2007 or August 31, 2007.

Debt securities for which the Company does not have the positive intent or ability to hold to maturity are classified as available-for-sale, along with any investments in equity securities. Securities classified as available-for-sale are marked-to-market at each reporting period. Changes in value on such securities are recorded as a component of *Accumulated comprehensive income.* The cost of securities sold is based on the specific identification method.

The following is a summary of marketable securities at November 30, 2007:

	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper	$ 607,546	$	$	$ 607,546
U.S. government debt securities with unrealized gains	99,523	665		100,188
U.S. corporate debt securities with unrealized gains	193,265	6,735		200,000
Total investments	900,334	7,400		907,734
Less cash equivalents	607,546			607,546
Total marketable securities	$ 292,788	$ 7,400	$	$ 300,188

The Company s marketable securities mature at various dates through January 2008. However, these securities represent the temporary investment of capital and it is not management s intent to hold these securities until maturity.

NOTE 3 INVESTMENTS IN WATER AND WATER SYSTEMS

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

	November 30, 2007		August 31, 2007	
	Costs	Accumulated Depreciation and Depletion	Costs	Accumulated Depreciation and Depletion
Arkansas River Valley assets	$ 81,234,547	$ (335,259)	$ 81,234,547	$ (265,466)
Rangeview water supply	13,966,462	(4,561)	13,949,036	(4,408)
Rangeview water system	167,720	(40,324)	167,720	(38,032)
Paradise water supply	5,528,818		5,525,017	
Fairgrounds water and water system	2,693,858	(116,203)	2,669,924	(94,325)
Sky Ranch water supply	100,000		100,000	
Water supply other	5,307	(1,160)	5,307	(893)
Totals	$ 103,696,712	$ (497,507)	$ 103,651,551	$ (403,124)
Net investments in water and water systems	$ 103,199,205		$ 103,248,427	

The Company s water rights and current water and wastewater service agreements are more fully described in Note 3 to the Company s 2007 Annual Report on Form 10-K.

NOTE 4 HP A&M PROMISSORY NOTES

Certain of the properties the Company acquired from HP A&M are subject to outstanding promissory notes with principal and accrued interest totaling approximately $13.8 million at November 30, 2007. Additional information regarding these promissory notes, the circumstances under which the Company would be required to make payments pursuant to these notes and the accounting treatment of these notes is more fully described in Note 3 to the Company s 2007 Annual Report on Form 10-K.

NOTE 5 CONSTRUCTION PROCEEDS RECEIVABLE

Pursuant to the Water Service Agreement (the County Agreement) with Arapahoe County (the County), as more fully described in Note 3 to the 2007 Annual Report on Form 10-K, the County is required to make monthly payments to the Company for the construction of the Special Facilities constructed at the County Fairgrounds. The monthly payments payable by the County were originally $6,850. This was calculated based on an original payable balance of approximately $607,900, which is the total capital expended by the Company for the Special Facilities of approximately $1.245 million less approximately $397,000 paid by the County up front and less approximately $240,000 for the value of the water rights to be transferred to the Company. However, pursuant to the County Agreement, because the County had not transferred the 336 acre-feet of water to the Company upon the completion of construction, the balance owed the Company was not reduced by the value of the water rights and is therefore still included in the construction proceeds receivable account. As a result, the monthly payments being charged to the County was increased to $9,555 upon completion of the facilities. The County made six payments of $9,555 each through December 2006, but then ceased making payments because the County disagreed with the increase. As a result, in October 2007, the Company and the County amended the County Agreement, whereby the County would (i) make the principal and interest payments on the original $607,900 balance owed to the Company (or approximately $6,850 per month for ten years), (ii) pay half of the interest (at 6% per annum) calculated on the value of the water rights that have not been transferred to the Company as of yet, and (iii) transfer the water rights valued at approximately $240,000 as soon as practical. The transfer of the water rights to the Company is currently being processed in the Colorado Water Court and the Company expects to receive the rights during its fiscal 2008. In addition, in October 2007 the County made a one-time payment of approximately $54,800, which represents the amounts past due under the amendment to the County Agreement.

NOTE 6 INVESTMENT IN WELL ENHANCEMENT AND RECOVERY SYSTEMS, LLC

Effective January 30, 2007, the Company entered into an Operating Agreement with Mr. R. Clark (who is deemed the indirect beneficial owner of 8.7% of the Company s common stock by means of his role as manager of TPC Ventures, LLC) and Hydro Resources, Inc. (collectively the Company, Mr. Clark and Hydro Resources, Inc. are referred to as the LLC Owners) to form Well Enhancement and Recovery Systems, LLC (Well Enhancement LLC). Well Enhancement LLC was established to develop a new deep water well enhancement tool which the LLC Owners believe will increase the efficiency of deep water wells in the Denver metropolitan area. Each of the LLC Owners holds a 1/3 interest in Well Enhancement LLC. The president of the Company acts as the manager of Well Enhancement LLC.

The Company accounts for its investment in Well Enhancement LLC under the equity method pursuant to Accounting Principles Board Opinion No. 18 *The Equity Method of Accounting for Investments in Common Stock (as amended)* and Emerging Issues Task Force Issue No. 03-16 *Accounting for Investments in Limited Liability Companies*. As of November 30, 2007, the Company s *Investment in Well Enhancement and Recovery Systems, LLC* account on its balance sheet includes $40,000 of capital contributions made to date by the Company (total initial capital contribution will be approximately $70,000 per LLC Owner) and its 1/3rd share of the approximately $108,600 of net losses of Well Enhancement LLC from its inception through November 30, 2007. As of November 30, 2007, Well Enhancement LLC s balance sheet consisted entirely of approximately $11,400 of cash and for the three and ten months ended November 30, 2007, Well Enhancement LLC posted net losses of approximately $1,900 and $108,600, respectively. The net losses are primarily a result of research and developments costs associated with the design of the well enhancement tool.

NOTE 7 PARTICIPATING INTERESTS IN EXPORT WATER

The Company acquired its Rangeview Water Supply through various amended agreements entered into in the early 1990 s. The acquisition was consummated with the signing of the Comprehensive Amendment Agreement No. 1 (the CAA) in 1996. Upon entering into the CAA, the Company recorded an initial liability of approximately $11.1 million, which represents the cash the Company received and used to purchase its Export Water Supply. In return, the Company agreed to remit a total of $31.8 million of proceeds received from the sale of Export Water to the Participating Interest holders. In accordance with EITF Issue No 88-18 *Sales of Future Revenues*, the obligation for the $11.1 million was recorded as debt, and the remaining $20.7 million contingent liability is not reflected on the

Company s balance sheet because the obligation to pay this is contingent on sales of Export Water, the amounts and timing of which are not reasonably determinable.

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As the proceeds from the sale of Export Water are received, and the amounts are remitted to the external CAA holders, the Company allocates a ratable percentage of this payment to the principal portion (the *Participating Interests in Export Water supply* liability account) with the balance of the payment being charged to the contingent obligation portion. The amount allocated to the liability is approximately 35%, which is the percentage the $11.1 million represented of the original total $31.8 million obligation. The remaining portion, or approximately 65%, is allocated to the contingent obligation. The portion allocated to principal will be recorded as a reduction in the *Participating Interests in Export Water* liability account while the amounts applied to the contingency are recorded on a net revenue basis when funds are received.

In recent years the Company has repurchased various portions of the CAA obligations in priority. The table below summarizes the transactions impacting the CAA obligations since its signing, which are explained in greater detail below the table:

	Export Water Proceeds Received	Export Water Proceeds to Pure Cycle	Total Potential Obligation	Paticipating Interests Liability	Contingency
Original balances	$	$ 218,500	$ 31,807,732	$ 11,090,630	$ 20,717,102
Activity from inception through August 31, 2007:					
Sky Ranch option payments	110,400	(42,280)	(68,120)	(23,754)	(44,366)
Acquisitions		23,398,234	(23,398,234)	(8,158,430)	(15,239,804)
Arapahoe County tap fees *	532,968	(373,078)	(159,890)	(55,754)	(104,136)
Export Water Sale payments	15,810	(11,067)	(4,743)	(1,655)	(3,088)
Balance at August 31, 2007	659,178	23,190,309	8,176,745	2,851,037	5,325,708
Activity during the three months ended November 30, 2007:					
Export Water Sale payments	3,366	(2,356)	(1,010)	(353)	(657)
Acquisitions		4,679,266	(4,679,266)	(1,631,553)	(3,047,713)
Balance at November 30, 2007	$ 662,544	$ 27,867,219	$ 3,496,469	$ 1,219,131	$ 2,277,338

* The Arapahoe County tap fees are less a $34,522 royalty payment to the Land Board.

In October 2007, the Company acquired the rights to approximately $4.7 million of CAA interests in exchange for 211,228 shares of the Company s restricted common stock valued at approximately $1.9 million. As a result, the Company now has the right to retain an additional $4.7 million of the initial $31.8 million of proceeds from the sale of Export Water. When combined with the CAA acquisitions and the payments made as a result of the sale of Export Water through August 31, 2007, as described in the Company s 2007 Annual Report on Form 10-K, the total remaining potential third party obligation as of November 30, 2007 is approximately $3.5 million. The Company

recorded a loss on the acquisition of the CAA interests in October 2007 of approximately $273,700.

The acquisition of these CAA obligations and debt reduction, reduces the long term impact of the CAA and provides the Company with additional cash flows to fund operations and pursue other business opportunities that may arise.

The CAA includes contractually established priorities. Following the CAA acquisition made by the Company, the Company s priority levels include $5.1 million of remaining amounts payable at the highest priority level, $2.5 million in the third priority level, and the remaining $20.3 million at various other priority levels.

The CAA obligation is non-interest bearing, and if the Export Water is not sold, the parties to the CAA have no recourse against the Company. If the Company does not sell the Export Water, the holders of the Series B Preferred Stock are also not entitled to payment of any dividend and have no contractual recourse against the Company.

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NOTE 8 STOCKHOLDERS EQUITY

Preferred and Common Stock. The Company s non-voting Series B Preferred Stock has a preference in liquidation of $1.00 per share less any dividends previously paid. Additionally, the Series B Preferred Stock is redeemable at the discretion of the Company for $1.00 per share less any dividends previously paid. In the event that the Company s proceeds from sale or disposition of Export Water rights exceeds $36,026,232, the Series B Preferred Stock holders will receive the next $433,513 of proceeds in the form of a dividend.

Equity Compensation Plan. The Company maintains the 2004 Incentive Plan (the Equity Plan) which was approved by stockholders in April 2004. Executives, eligible employees and non-employee directors are eligible to receive option and restricted stock grants pursuant to the Equity Plan. Under the Equity Plan, options to purchase shares of stock, and restricted stock awards, can be granted with exercise prices and vesting periods determined by the Compensation Committee of the Board. The Company initially reserved 1.6&