



**Pennichuck Corporation**

**Quarterly Report to the**

**Sole Shareholder**

**(City of Nashua Board of Aldermen)**

**Quarter Ended June 30, 2016**

## **Executive Summary**

- Revenues for the second quarter of 2016 were 2.0% lower than the prior year (\$10.7 million for 2016 versus \$10.9 million for 2015). Revenues on a year-to-date basis were flat when compared to the prior year (\$19.4 million for the six months in 2016 versus \$19.4 million in 2015).
- Operating Income for the second quarter of 2016 was 26.4% below the prior year (\$2.2 million for 2016 versus \$3.0 million for 2015). Operating Income on a year-to-date basis is 25.9% lower than the prior year (\$2.7 million for 2016 versus \$3.7 million for 2015).
- Pre-Tax Income for the second quarter of 2016 was \$0.5 million versus \$0.2 million for 2015. On a year-to-date basis, the pre-tax loss was \$1.7 million for 2016 versus \$1.4 million for 2015.
- Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA) for the second quarter of 2016 was 2.2% higher than the prior year (\$4.6 million in 2016 versus \$4.5 million for 2015). On a year-to-date basis, EBITDA was \$6.9 million for 2016 versus \$6.8 million for 2015.
- During the quarter, the Company paid \$2.1 million to the City in principal, interest and dividends to fund the City Acquisition Debt. Year-to-date, the Company has paid \$4.2 million to the City in principal, interest and dividends to fund the City Acquisition Debt.
- Capital expenditures for the second quarter of 2016 were \$4.4 million compared to \$2.4 million in the second quarter of 2015. On a year-to-date basis, capital expenditures for 2016 were \$6.3 million compared to \$3.4 million in 2015.

We remain focused on the Company’s primary mission, in that we continue to provide clean water and excellent service to our customers and operate within the confines of the budgeted and planned levels of operating and capital expenditures.

### **Unaudited Financial Highlights**

Financial highlights on a Generally Accepted Accounting Principles (“GAAP”) basis for the second quarter of 2016 as compared to the second quarter of 2015, and the six months of 2016 as compared to the six months of 2015, are as follows:

	(\$000’s)			
	<u>Quarter Ended</u>		<u>Year-to-Date</u>	
	<u>June 30, 2016</u>	<u>June 30, 2015</u>	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Revenues				
Regulated Utilities	\$ 9,802	\$ 10,140	\$ 17,603	\$ 17,810
Other	<u>913</u>	<u>795</u>	<u>1,801</u>	<u>1,591</u>
Total	\$ 10,715	\$ 10,935	\$ 19,404	\$ 19,401
Operating Expenses				
Regulated Utilities	\$ 7,539	\$ 7,141	\$ 14,763	\$ 14,135
Other	<u>988</u>	<u>822</u>	<u>1,900</u>	<u>1,566</u>
Total	\$ 8,527	\$ 7,963	\$ 16,663	\$ 15,701
Operating Income	\$ 2,188	\$ 2,972	\$ 2,741	\$ 3,700
Non-Operational Income (Expense)	788	(41)	830	(48)
Net Interest Expense	<u>(2,510)</u>	<u>(2,699)</u>	<u>(5,286)</u>	<u>(5,066)</u>
Pre-Tax Income (Loss)	\$ 466	\$ 232	\$ (1,715)	\$ (1,414)
Income Tax Benefit (Expense)	<u>(345)</u>	<u>(180)</u>	<u>256</u>	<u>143</u>
Net Income (Loss)	\$ <u>121</u>	\$ <u>52</u>	\$ (1,459)	\$ (1,271)
Earnings Before Interest, Taxes, Depreciation and Amortization	\$ <u>4,611</u>	\$ <u>4,540</u>	\$ <u>6,874</u>	\$ <u>6,849</u>

Revenues from the water utility operations decreased 3.3% in the quarter and 1.2% on an annual basis versus last year. Accrued revenues include actual billed amounts through the June billing cycles, plus an accrual of unbilled amounts through the end of the month (based upon trailing consumption patterns). Revenues from the unregulated water service business have increased 14.8% in the second quarter over the prior year, primarily due to unplanned maintenance activities. On a year-to-date basis, the unregulated water service revenues are up by 13.3%.

Operating Expenses have increased approximately 7.1% in the second quarter and 6.1% on a year-to-year basis. The increase is mainly attributable to increased direct operating costs associated with the increase in water consumption levels, as well as increases in real estate taxes and labor costs.

Operating Income has decreased year-over-year as a result of the variation in revenue and operating expense levels recognized year-to-date.

Interest Expense decreased in the second quarter due to a partial refund of interest payments related to one of our State Revolving Fund (“SRF”) notes payable. However, year-over-year it has increased 5.3% resulting from the interest costs associated with the additional financed amounts for capital projects which have been incurred for ongoing infrastructure replacement, in conformity with the Company’s key mission objectives.

The second quarter pre-tax income and year-to-date pretax loss for 2016 are both at higher earned amounts than the pretax levels for 2015 due to the revenue and expense variations discussed above.

The year-to-date income tax benefit in the current year reflects the treatment for the Municipal Acquisition Regulatory Asset, which is not deductible for tax purposes. Therefore, the tax benefit is 14.9% versus the statutory rate benefit of 39.6% on a year-to-date basis.

Earnings before interest, taxes, depreciation and amortization (EBITDA) are higher than EBITDA for the same periods last year due to increases in Non-Operational Income (Expense) that are discussed in the Subsequent Events section.

	(\$000's)	
<b><i>Balance Sheet</i></b>	As of <u>June 30, 2016</u> (Unaudited)	As of <u>December 31, 2015</u> (Audited)
<b><u>Assets</u></b>		
Property, Plant & Equipment, Net	\$ <u>186,743</u>	\$ <u>183,241</u>
Current Assets:		
Cash	956	1,246
Restricted Cash	5,676	5,729
Investments – 2014 and 2015 Bond Project Funds	13,227	19,778
Accounts Receivable	5,953	4,502
Inventory	743	712
Other Current Assets <sup>Note 1</sup>	<u>1,956</u>	<u>2,233</u>
Total Current Assets	<u>28,511</u>	<u>34,200</u>
Other Assets:		
Acquisition Premium <sup>Note 2</sup>	76,087	77,028
Other Assets	<u>15,881</u>	<u>16,194</u>
Total Other Assets	<u>91,968</u>	<u>93,222</u>
TOTAL ASSETS	\$ <u>307,222</u>	\$ <u>310,663</u>
<b><u>Shareholder's Equity and Liabilities</u></b>		
Shareholder's Equity	\$ <u>20,333</u>	\$ <u>22,041</u>
Bonds, Notes and Mortgages	<u>203,955</u>	<u>206,052</u>
Current Liabilities:		
Current Portion of Long-Term Debt	4,880	4,120
Other Current Liabilities	<u>3,256</u>	<u>3,490</u>
Total Current Liabilities	<u>8,136</u>	<u>7,610</u>
Other Long-Term Liabilities:		
CIAC, net	37,914	37,929
Deferred Income Taxes	20,340	20,642
Accrued Pension Liability <sup>Note 3</sup>	8,342	8,286
Other Long-Term Liabilities	<u>8,202</u>	<u>8,103</u>
Total Other Long-Term Liabilities	<u>74,798</u>	<u>74,960</u>
TOTAL SHAREHOLDER'S EQUITY AND LIABILITIES	\$ <u>307,222</u>	\$ <u>310,663</u>

Note 1 (Other Current Assets) – At December 31, 2015, approximately \$1.3 million of this balance is comprised of prepaid property taxes, which were expensed in the first quarter of 2016, relating to taxes paid in November and December of 2015 for the second half of the property tax year ended March 31, 2016. The balance in prepaid property taxes as of June 30, 2016 is \$1.1 million, relating to amounts due in November and December of this year.

Note 2 – In accordance with GAAP, the Acquisition Premium is being written-off over the 30-year life of the principal of the City Acquisition Debt. The difference in the balance of Acquisition Premium between December 31, 2015 and June 30, 2016 is due to the amortization for the six months of 2016.

Note 3 (Accrued Pension Liability) – During the six months of 2016, \$425,000 was contributed into the Pension Plan, while approximately \$300,000 in benefit payments were made to participants and approximately \$243,000 of investment income and appreciation was earned in the plan.

**Unaudited Cash Flow Statement**

Cash Flow on a GAAP basis for the second quarter of 2016 as compared to the second quarter of 2015, and the year-to-date 2016 versus 2015, are as follows:

	(\$000's)			
	Quarter Ended		Year-to-Date	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Operating Activities:				
Net Income (Loss)	\$ 121	\$ 52	\$ (1,459)	\$ (1,271)
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by Operating Activities:				
Depreciation and Amortization	1,671	1,665	3,423	2,977
Provision for Deferred Taxes	359	194	(229)	(116)
Other	(37)	(10)	(59)	(18)
Changes in Assets and Liabilities:				
(Increase) Decrease in Accounts Receivable	(1,774)	(1,885)	(1,451)	(1,736)
(Increase) Decrease in Inventory	(35)	(67)	(31)	(43)
(Increase) Decrease in Other Assets	(894)	(1,056)	737	320
Increase (Decrease) in Accounts Payable	21	927	361	333
Increase (Decrease) in Other Liabilities	(405)	(674)	(503)	(229)
Net Cash Provided by (Used in) Operating Activities	<u>(973)</u>	<u>(854)</u>	<u>789</u>	<u>217</u>
Investing Activities:				
Purchases of Property, Plant & Equipment, including the Debt Component of AFUDC	(4,363)	(2,522)	(6,877)	(3,734)
Proceeds from Sale of Property, Plant & Equipment	702	-	702	-
(Increase) Decrease in Restricted Cash	(3,706)	1,151	(8,374)	25,108
Sale of Investment Securities	7,977	-	14,979	-
Change in Deferred Land Costs	(2)	-	4	-
Net Cash Provided by (Used in) Investing Activities	<u>608</u>	<u>(1,371)</u>	<u>434</u>	<u>21,374</u>
Financing Activities:				
Borrowings (Repayments) on Line of Credit	-	-	-	-
Payments on Long-term Debt	(672)	(628)	(2,770)	(24,994)
Contributions in Aid of Construction	18	15	21	15
Proceeds from Long-term Borrowings	1,364	591	1,433	2,227
Debt Issuance Costs	(33)	(47)	(57)	(105)
Dividends Paid	(70)	(69)	(140)	(138)
Net Cash Provided by (Used in) Financing Activities	<u>607</u>	<u>(138)</u>	<u>(1,513)</u>	<u>(22,995)</u>
Increase (Decrease) in Cash and Cash Equivalents	242	(2,363)	(290)	(1,404)
Cash and Cash Equivalents at Beginning of Period	<u>714</u>	<u>3,946</u>	<u>1,246</u>	<u>2,987</u>
Cash and Cash Equivalents at End of Period	<u>\$ 956</u>	<u>\$ 1,583</u>	<u>\$ 956</u>	<u>\$ 1,583</u>

Financial information is available on the Company's website ([www.Pennichuck.com](http://www.Pennichuck.com)) under the "Company Reports" caption.

## **Capital Expenditures**

Capital Expenditures in the second quarter of 2016 were \$4.4 million as compared to \$2.4 million in the second quarter of 2015. Capital Expenditures for the year-to-date were \$6.3 million as compared to \$3.4 million in 2015.

Major expenditures in the first half of 2016 included:

New Operations Building Design and Construction	\$ 2,017,000
Harris Dam Spillway Reconstruction	1,503,000
Dean & Main Building Renovations	317,000
Asset Management, GIS, Data Presentation System	297,000
Maple Haven Booster Station Upgrade	225,000
Merrimack Raw Water Transmission Main	197,000

## **Subsequent Events**

### ***Financing***

On May 9, 2016, the New Hampshire Public Utilities Commission issued Order No. 25,896 approving a Water Infrastructure and Conservation Adjustment (WICA) surcharge of 3.03% for customers of Pennichuck Water Works, Inc. in the Nashua Core System. The surcharge is effective for service rendered on and after June 1, 2016. The Order was effective May 31, 2016.

On June 2, 2016, Pennichuck Water Works, Inc. completed a financing transaction with the New Hampshire Department of Environmental Services under the State of New Hampshire's Drinking Water Revolving Loan Fund (the "SRF") in the amount of \$1,400,000 for a 30-year term at an interest rate of 2.5%. The loan will fund the replacement of a portion of the water mains on Amherst Street, and up to three adjoining streets, in Nashua.

On June 2, 2016, Pennichuck East Utility, Inc. completed a financing transaction with the New Hampshire Department of Environmental Services under the State of New Hampshire's Drinking Water Revolving Loan Fund in the amount of \$1,650,000 for a 20-year term at an interest rate of 2.5%. The loan will fund the replacement of a water main on Varney Road in the Locke Lake water system in Barnstead.

On June 2, 2016, Pittsfield Aqueduct Company, Inc. completed a financing transaction with the New Hampshire Department of Environmental Services under the State of New Hampshire's Drinking Water Revolving Loan Fund in the amount of \$440,000 for a 30-year term at an interest rate of 3.2%. The loan will fund the installation of a water main on Fairview Street and Catamount Road in Pittsfield.



On June 16, 2016, Pennichuck East Utility, Inc. completed a financing transaction with CoBank, ACB in the amount of \$2,200,000 for a term of 25 years at an interest rate of 4.2% to be used for non-SRF funded capital improvement projects being completed in 2016. Of this amount, \$1.25 million was drawn down at closing, with the remaining \$950,000 to be drawn down in the fourth quarter of 2016.

***Non-Operational Income (Expense)***

On June 30, 2016, our Will Street Operations Facility was sold for \$1,010,000. A net gain of \$702,000 from this transaction was recognized in June, after the recognition of the payment of direct selling expenses and the write-off of net book value carrying costs for the property. As contemplated at the time that the net total funding was procured for the construction of the new Operations Building, the net cash proceeds from this sale will be used in the completion and payment of the new facility in Merrimack. We will continue to occupy the Will Street Operations Facility as a \$0 triple-net tenant until the new facility is ready for occupancy, which is scheduled to be ready in December 2016.

***Educational Programs***

During the week of May 2<sup>nd</sup>, the Company celebrated Water Week by providing tours of the Concord Street Water Treatment Plant to 4<sup>th</sup> grade students from the Nashua school system.

The Company provided a water protection program to the 5<sup>th</sup> grade students of the Nashua school system and sponsored a poster contest for the students.