



Pennichuck Corporation

Quarterly Report to the

Sole Shareholder

(City of Nashua Board of Aldermen)

Quarter Ended September 30, 2016

Executive Summary

- Revenues for the third quarter of 2016 were 15.6% higher than the prior year (\$14.5 million for 2016 versus \$12.5 million for 2015). Revenues on a year-to-date basis increased 6.1% over last year (\$33.9 million for the nine months in 2016 versus \$31.9 million in 2015).
- Operating Income for the third quarter of 2016 was 28.5% higher than the prior year (\$5.5 million for 2016 versus \$4.3 million for 2015). Operating Income on a year-to-date basis is 3.3% higher than the prior year (\$8.3 million for 2016 versus \$8.0 million for 2015).
- Pre-Tax Income for the third quarter of 2016 was \$2.8 million versus \$1.6 million for 2015. On a year-to-date basis, the pre-tax income was \$1.1 million for 2016 versus \$0.2 million for 2015.
- Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA) for the third quarter of 2016 was 21.8% higher than the prior year (\$7.2 million in 2016 versus \$5.9 million for 2015). On a year-to-date basis, EBITDA was \$14.0 million for 2016 versus \$12.7 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 \$6.4 million to the City in principal, interest and dividends to fund the City Acquisition Debt.
- Capital expenditures for the third quarter of 2016 were \$6.4 million compared to \$4.6 million in the third quarter of 2015. On a year-to-date basis, capital expenditures for 2016 were \$12.7 million compared to \$8.0 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 third quarter of 2016 as compared to the third quarter of 2015, and the nine months of 2016 as compared to the nine months of 2015, are as follows:

	(\$000’s)			
	<u>Quarter Ended</u>		<u>Year-to-Date</u>	
	<u>September 30, 2016</u>	<u>September 30, 2015</u>	<u>September 30, 2016</u>	<u>September 30, 2015</u>
Revenues				
Regulated Utilities	\$ 13,572	\$ 11,748	\$ 31,175	\$ 29,558
Other	<u>933</u>	<u>797</u>	<u>2,734</u>	<u>2,388</u>
Total	\$ 14,505	\$ 12,545	\$ 33,909	\$ 31,946
Operating Expenses				
Regulated Utilities	\$ 8,126	\$ 7,542	\$ 22,889	\$ 21,677
Other	<u>866</u>	<u>714</u>	<u>2,766</u>	<u>2,280</u>
Total	\$ 8,992	\$ 8,256	\$ 25,655	\$ 23,957
Operating Income	\$ 5,513	\$ 4,289	\$ 8,254	\$ 7,989
Non-Operational Income (Expense)	27	11	857	(37)
Net Interest Expense	<u>(2,747)</u>	<u>(2,694)</u>	<u>(8,033)</u>	<u>(7,760)</u>
Pre-Tax Income (Loss)	\$ 2,793	\$ 1,606	\$ 1,078	\$ 192
Income Tax Benefit (Expense)	<u>(466)</u>	<u>(154)</u>	<u>(210)</u>	<u>(11)</u>
Net Income (Loss)	\$ 2,327	\$ 1,452	\$ 868	\$ 181
Earnings Before Interest, Taxes, Depreciation and Amortization	\$ <u>7,169</u>	\$ <u>5,886</u>	\$ <u>14,043</u>	\$ <u>12,735</u>

Revenues from the water utility operations increased 15.5% in the quarter and 5.5% on an annual basis versus last year. Accrued revenues include actual billed amounts through the September 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 17.1% in the third 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 14.5%.

Operating Expenses have increased approximately 8.9% in the third quarter and 7.1% on a year-to-year basis, compared to the same periods in 2015. 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 increased year-over-year as a result of the variation in revenue and operating expense levels recognized year-to-date.

Interest Expense year-over-year for the first nine months has increased 3.5% 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 third quarter and year-to-date pretax income 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 expense in the current year reflects the treatment for the Municipal Acquisition Regulatory Asset, which is not deductible for tax purposes. Therefore, the tax expense is 19.5% 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)	
<i>Balance Sheet</i>	As of <u>September 30, 2016</u> (Unaudited)	As of <u>December 31, 2015</u> (Audited)
<u>Assets</u>		
Property, Plant & Equipment, Net	\$ 192,858	\$ <u>183,241</u>
Current Assets:		
Cash	5,434	1,246
Restricted Cash	6,737	5,729
Investments – 2014 and 2015 Bond Project Funds	7,892	19,778
Accounts Receivable	7,090	4,502
Inventory	681	712
Other Current Assets ^{Note 1}	<u>941</u>	<u>2,233</u>
Total Current Assets	<u>28,775</u>	<u>34,200</u>
Other Assets:		
Acquisition Premium ^{Note 2}	75,616	77,028
Other Assets	<u>15,703</u>	<u>16,194</u>
Total Other Assets	<u>91,319</u>	<u>93,222</u>
TOTAL ASSETS	\$ <u>312,952</u>	\$ <u>310,663</u>
<u>Shareholder's Equity and Liabilities</u>		
Shareholder's Equity	\$ <u>22,620</u>	\$ <u>22,041</u>
Bonds, Notes and Mortgages	<u>204,206</u>	<u>206,052</u>
Current Liabilities:		
Current Portion of Long-Term Debt	5,081	4,120
Other Current Liabilities	<u>5,512</u>	<u>3,490</u>
Total Current Liabilities	<u>10,593</u>	<u>7,610</u>
Other Long-Term Liabilities:		
CIAC, net	38,320	37,929
Deferred Income Taxes	20,841	20,642
Accrued Pension Liability ^{Note 3}	8,254	8,286
Other Long-Term Liabilities	<u>8,118</u>	<u>8,103</u>
Total Other Long-Term Liabilities	<u>75,533</u>	<u>74,960</u>
TOTAL SHAREHOLDER'S EQUITY AND LIABILITIES	\$ <u>312,952</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 September 30, 2016 is zero, as we are fully into the second half of the property tax year for accrual accounting purposes.

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 September 30, 2016 is due to the amortization for the nine months of 2016.

Note 3 (Accrued Pension Liability) – During the nine months of 2016, \$753,700 was contributed into the Pension Plan, while approximately \$452,000 in benefit payments were made to participants and approximately \$828,000 of investment income and appreciation was earned in the plan.

Unaudited Cash Flow Statement

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

	(\$000's)			
	Quarter Ended		Year-to-Date	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Operating Activities:				
Net Income (Loss)	\$ <u>2,327</u>	\$ <u>1,452</u>	\$ <u>868</u>	\$ <u>181</u>
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by Operating Activities:				
Depreciation and Amortization	1,726	1,689	5,149	4,672
Provision for Deferred Taxes	480	166	251	50
Other	(48)	(9)	(107)	(33)
Changes in Assets and Liabilities:				
(Increase) Decrease in Accounts Receivable	(1,137)	(165)	(2,588)	(1,901)
(Increase) Decrease in Inventory	61	80	30	37
(Increase) Decrease in Other Assets	1,264	1,061	2,001	1,381
Increase (Decrease) in Accounts Payable	899	(508)	1,260	(175)
Increase (Decrease) in Other Liabilities	<u>1,275</u>	<u>250</u>	<u>774</u>	<u>21</u>
Net Cash Provided by (Used in) Operating Activities	<u>6,847</u>	<u>4,016</u>	<u>7,638</u>	<u>4,233</u>
Investing Activities:				
Purchases of Property, Plant & Equipment, including the Debt Component of AFUDC	(6,964)	(4,917)	(13,843)	(8,651)
Proceeds from Sale of Property, Plant & Equipment	(67)	-	635	-
(Increase) Decrease in Restricted Cash	2,016	656	(6,358)	25,764
Sale of Investment Securities	2,257	-	17,236	-
Change in Deferred Land Costs	<u>3</u>	<u>(5)</u>	<u>7</u>	<u>(5)</u>
Net Cash Provided by (Used in) Investing Activities	<u>(2,755)</u>	<u>(4,266)</u>	<u>(2,323)</u>	<u>17,108</u>
Financing Activities:				
Borrowings (Repayments) on Line of Credit	-	-	-	-
Payments on Long-term Debt	(720)	(641)	(3,490)	(25,635)
Contributions in Aid of Construction	4	-	25	15
Proceeds from Long-term Borrowings	1,172	2,141	2,605	4,368
Debt Issuance Costs	0	(32)	(57)	(137)
Dividends Paid	<u>(70)</u>	<u>(69)</u>	<u>(210)</u>	<u>(207)</u>
Net Cash Provided by (Used in) Financing Activities	<u>386</u>	<u>1,399</u>	<u>(1,127)</u>	<u>(21,596)</u>
Increase (Decrease) in Cash and Cash Equivalents	4,478	1,149	4,188	(255)
Cash and Cash Equivalents at Beginning of Period	<u>956</u>	<u>1,583</u>	<u>1,246</u>	<u>2,987</u>
Cash and Cash Equivalents at End of Period	\$ <u>5,434</u>	\$ <u>2,732</u>	\$ <u>5,434</u>	\$ <u>2,732</u>

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

Capital Expenditures

Capital Expenditures in the third quarter of 2016 were \$6.4 million as compared to \$4.6 million in the third quarter of 2015. Capital Expenditures for the year-to-date were \$12.7 million as compared to \$8.0 million in 2015.

Major expenditures in the nine months of 2016 included:

New Operations Building Design and Construction	\$ 5,126,000
Harris Dam Spillway Reconstruction	1,922,000
Locke Lake, Varney Road – Water Main	1,458,000
Merrimack Raw Water Transmission Main	517,000
Asset Management, GIS, Data Presentation System	439,000
Dean & Main Building Renovations	317,000

Subsequent Events

Rate Case – Pennichuck Water Works, Inc.

On September 23, 2016, Pennichuck Water Works, Inc. (“PWW”) filed a request with the New Hampshire Public Utilities Commission (“NHPUC”) for a rate increase of 17.21% over its current rates for the test year 2015, for which 7.86% is related to a permanent rate increase, and 9.35% is related to a prospective step increase (associated with capital investments and other allowable expenditures in the twelve months following the test year). The overall rate increase is subject to the normal regulatory filing process with the NHPUC, as followed for all prior rate case filings, and as such, the final permanent rate increase granted will be effective retroactive back to the filing date, once approved by the NHPUC. The step increase, once approved and granted, would be earned on a forward looking basis, as of the date of the order granting such increase. In addition, PWW has requested that a temporary rate increase of 6.21% be granted as a subset of the final permanent rate increase, with the intention that this temporary rate increase would be approved very early in 2017. The request for this overall increase is based upon increases in PWW’s operating costs since the last allowed rate increase in 2010/2011 (for the 2009 test year), as well as revenues needed to pay the debt service on over \$40 million of infrastructure replacements made since the last rate case, with those dollars being invested in its real property assets, distribution and treatment systems, and other necessary capital items, to ensure continued compliance with the Safe Drinking Water Act and prudent ongoing replacement of aging infrastructure to properly maintain the company’s operating systems. A prehearing conference on the rate case filing is set for November 21, 2016 at the NHPUC, and notices were mailed to all PWW customers along with a FAQ fact sheet, on November 7, 2016.

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 \$636,000 from this transaction was recognized, 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 on or about December 10, 2016.