



Pennichuck Corporation

**Quarterly Report to the
Sole Shareholder
(City of Nashua Board of Aldermen)**

Quarter Ended June 30, 2017

Executive Summary

- Revenues for the second quarter of 2017 were 10.3% lower than the prior year (\$9.6 million for 2017 versus \$10.7 million for 2016). Revenues on a year-to-date basis were lower when compared to the prior year (\$18.5 million for the six months in 2017 versus \$19.4 million in 2016). Both are primarily due to lower consumption in 2017 versus 2016, as the drought abated in the late spring of this year.
- Operating Income for the second quarter of 2017 was 61.9% below the prior year (\$0.8 million for 2017 versus \$2.1 million for 2016). Operating Income on a year-to-date basis is 60.0% lower than the prior year (\$1.1 million for 2017 versus \$2.7 million for 2016). Both of which are primarily attributed to the lower revenue levels year over year.
- Pre-Tax Loss for the second quarter of 2017 was \$1.9 million versus pre-tax income of \$0.5 million for 2016. On a year-to-date basis, the pre-tax loss was \$4.3 million for 2017 versus \$1.7 million for 2016.
- Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA) for the second quarter of 2017 was 39.1% lower than the prior year (\$2.8 million in 2017 versus \$4.6 million for 2016). On a year-to-date basis, EBITDA was \$5.0 million for 2017 versus \$6.9 million for 2016.
- 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 2017 were \$1.2 million compared to \$4.4 million in the second quarter of 2016. On a year-to-date basis, capital expenditures for 2017 were \$2.3 million compared to \$6.3 million in 2016.

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 2017 as compared to the second quarter of 2016, and the six months of 2017 as compared to the six months of 2016, are as follows:

	(000’s)			
	<u>Quarter Ended</u>		<u>Year-to-Date</u>	
	<u>June 30, 2017</u>	<u>June 30, 2016</u>	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Revenues				
Regulated Utilities	\$ 8,775	\$ 9,802	\$ 16,828	\$ 17,603
Other	<u>888</u>	<u>913</u>	<u>1,708</u>	<u>1,801</u>
Total	\$ 9,663	\$ 10,715	\$ 18,536	\$ 19,404
Operating Expenses				
Regulated Utilities	\$ 7,909	\$ 7,539	\$ 15,671	\$ 14,763
Other	<u>920</u>	<u>988</u>	<u>1,768</u>	<u>1,900</u>
Total	\$ 8,829	\$ 8,527	\$ 17,439	\$ 16,663
Operating Income	\$ 834	\$ 2,188	\$ 1,097	\$ 2,741
Non-Operational Income (Expense)	(1)	788	(2)	830
Net Interest Expense	<u>(2,722)</u>	<u>(2,510)</u>	<u>(5,382)</u>	<u>(5,286)</u>
Pre-Tax Income (Loss)	\$ (1,889)	\$ 466	\$ (4,287)	\$ (1,715)
Income Tax Benefit (Expense)	<u>(33)</u>	<u>(345)</u>	<u>964</u>	<u>256</u>
Net Income (Loss)	\$ <u>(1,922)</u>	\$ <u>121</u>	\$ <u>(3,323)</u>	\$ <u>(1,459)</u>
Earnings Before Interest, Taxes, Depreciation and Amortization	\$ <u>2,766</u>	\$ <u>4,611</u>	\$ <u>4,962</u>	\$ <u>6,874</u>

Revenues from water utility operations decreased 10.5% in the quarter and 4.4% on a year-to-date basis, versus last year. Revenues include actual billed amounts through and including 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 decreased 2.7% in the second quarter as compared to the second quarter of last year, primarily due to a reduction in “cost plus” contract work from unplanned maintenance activities. On a year-to-date basis, the unregulated water service revenues are down by 5.2%, for the same reason.

Operating Expenses have increased approximately 3.4% in the second quarter and 4.5% on a year-to-year basis. The increase is mainly attributable to increased direct operating costs associated with increases in real estate taxes, labor and health insurance costs.

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

Interest Expense increased in the second quarter by approximately 8% over the second quarter of last year; and, year-to-date versus last year it has increased approximately 2%, 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 loss and year-to-date pretax loss for 2017 are both higher than the pretax levels for 2016 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 22.5% versus the statutory rate benefit of 39.4% on a year-to-date basis.

Earnings before interest, taxes, depreciation and amortization (EBITDA) are lower than EBITDA for the same periods last year due to increased operating costs, coupled with lower revenue levels and lower non-operational income related to the sale of the Will Street Operations Facility in June 2016.

Balance Sheet

	(000's)	
	As of June 30, 2017 (Unaudited)	As of December 31, 2016 (Audited)
<u>Assets</u>		
Property, Plant & Equipment, Net	\$ <u>205,383</u>	\$ <u>201,698</u>
Current Assets:		
Cash	729	2,446
Restricted Cash	6,289	6,530
Restricted Cash–2014 and 2015 Bond Project Funds	-	7,568
Accounts Receivable ^{Note 1}	5,967	6,086
Inventory	654	666
Other Current Assets ^{Note 2}	<u>2,157</u>	<u>2,047</u>
Total Current Assets	<u>15,796</u>	<u>25,343</u>
Other Assets:		
Acquisition Premium	74,187	75,144
Other Assets	<u>12,257</u>	<u>12,410</u>
Total Other Assets	<u>86,444</u>	<u>87,554</u>
TOTAL ASSETS	\$ <u>307,623</u>	\$ <u>314,595</u>
<u>Shareholders' Equity and Liabilities</u>		
Shareholders' Equity	\$ <u>17,124</u>	\$ <u>20,578</u>
Bonds, Notes and Mortgages	<u>198,509</u>	<u>200,758</u>
Current Liabilities:		
Current Portion of Long-Term Debt	5,368	5,162
Other Current Liabilities ^{Notes 3 and 4}	<u>5,264</u>	<u>9,798</u>
Total Current Liabilities	<u>10,632</u>	<u>14,960</u>
Other Long-Term Liabilities:		
CIAC, net	44,380	40,364
Deferred Income Taxes	19,940	20,869
Accrued Pension Liability ^{Note 5}	9,024	9,010
Other Long-Term Liabilities	<u>8,014</u>	<u>8,056</u>
Total Other Long-Term Liabilities	<u>81,358</u>	<u>78,299</u>
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES	\$ <u>307,623</u>	\$ <u>314,595</u>

Notes to Balance Sheet

Note 1 (Accounts Receivable) – At December 31, 2016, approximately \$1,250,000 of this balance was comprised of PFOA reimbursable costs from Saint-Gobain Performance Plastics Corporation, for design and expansion of public water to residents in the Town of Litchfield. The balance in accounts receivable for these reimbursable costs incurred during the second quarter, as of June 30, 2016 is \$762,000.

Note 2 (Other Current Assets) – At December 31, 2016, approximately \$1,163,000 of this balance was comprised of prepaid property taxes, which were expensed in the first quarter of 2017, relating to taxes paid in November and December of 2016 for the second half of the property tax year ended March 31, 2017. The balance of prepaid property taxes as of June 30, 2017 is \$1,160,000.

Note 3 (Other Current Liabilities) – At December 31, 2016, approximately \$6,300,000 of this balance was comprised of accounts payable, as well as PFOA reimbursable costs from Saint-Gobain Performance Plastics Corporation, for design and expansion of public water to residents in the Town of Litchfield. The accounts payable balance remaining, inclusive of these reimbursable costs as of June 30, 2017 is \$3,575,000, as it relates to activities that were performed in the second quarter.

Note 4 (Other Current Liabilities) – At December 31, 2016, approximately \$1,700,000 of this balance was comprised of accrued interest, which were expensed during the first six months of 2017. These interest costs are associated with the financed amounts for capital projects which have been incurred for ongoing infrastructure replacement, in conformity with the Company's key mission objectives.

Note 5 (Accrued Pension Liability) – During the six months of 2017, \$482,000 was contributed into the Pension Plan, while approximately \$343,000 in benefit payments were made to participants and approximately \$950,000 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 2017 as compared to the second quarter of 2016, and the year-to-date 2017 versus 2016, are as follows:

	(000's)			
	Quarter Ended		Year-to-Date	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Operating Activities:				
Net Income (Loss)	\$ (1,922)	\$ 121	\$ (3,323)	\$ (1,459)
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by Operating Activities:				
Depreciation and Amortization	1,934	1,671	3,867	3,423
Provision for Deferred Taxes	48	359	(936)	(229)
Other	(6)	(37)	(45)	(59)
Changes in Assets and Liabilities:				
(Increase) Decrease in Accounts Receivable	(1,708)	(1,774)	119	(1,451)
(Increase) Decrease in Inventory	54	(35)	12	(31)
(Increase) Decrease in Other Assets	(1,073)	(894)	124	737
Increase (Decrease) in Accounts Payable	1,676	21	(2,693)	361
Increase (Decrease) in Other Liabilities	<u>(1,074)</u>	<u>(405)</u>	<u>(1,778)</u>	<u>(503)</u>
Net Cash Provided by (Used in) Operating Activities	<u>(2,071)</u>	<u>(973)</u>	<u>(4,653)</u>	<u>789</u>
Investing Activities:				
Purchases of Property, Plant & Equipment, including the Debt Component of AFUDC	(1,252)	(4,363)	(2,615)	(6,877)
Proceeds from Sale of Property, Plant & Equipment	-	702	37	702
(Increase) Decrease in Restricted Cash	2,863	(3,706)	7,809	(8,374)
Sale of Investment Securities	-	7,977	-	14,979
Change in Deferred Land Costs	<u>-</u>	<u>(2)</u>	<u>-</u>	<u>4</u>
Net Cash Provided by (Used in) Investing Activities	<u>1,611</u>	<u>608</u>	<u>5,231</u>	<u>434</u>
Financing Activities:				
Borrowings (Repayments) on Line of Credit	-	-	-	-
Payments on Long-term Debt	(768)	(672)	(3,628)	(2,770)
Contributions in Aid of Construction	17	18	18	21
Proceeds from Long-term Borrowings	393	1,364	1,439	1,433
Debt Issuance Costs	15	(33)	15	(57)
Dividends Paid	<u>(69)</u>	<u>(70)</u>	<u>(139)</u>	<u>(140)</u>
Net Cash Provided by (Used in) Financing Activities	<u>(412)</u>	<u>607</u>	<u>(2,295)</u>	<u>(1,513)</u>
Increase (Decrease) in Cash and Cash Equivalents	(872)	242	(1,717)	(290)
Cash and Cash Equivalents at Beginning of Period	<u>1,601</u>	<u>714</u>	<u>2,446</u>	<u>1,246</u>
Cash and Cash Equivalents at End of Period	<u>\$ 729</u>	<u>\$ 956</u>	<u>\$ 729</u>	<u>\$ 956</u>

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

Capital Expenditures

Capital Expenditures in the second quarter of 2017 were \$1.2 million as compared to \$4.4 million in the second quarter of 2016. Capital Expenditures for the year-to-date were \$2.3 million as compared to \$6.3 million in 2016.

Major expenditures in the first half of 2017 included:

Amherst Street, Nashua – Main Improvements	\$ 378,000
PWW-PEU Interconnection Design Evaluation	\$ 318,000
Asset Management, GIS, Data Presentation System	\$ 196,000
Meter Replacements	\$ 196,000
PEU – New Source for Hardwood CWS, Windham	\$ 130,000
Temple Street, Nashua – Main Improvements	\$ 119,000

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% was related to a permanent rate increase, and 9.35% was 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 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 Company, NHPUC Staff and the Office of Consumer Advocate agreed to a temporary rate increase at “current rates,” and as such, there was no impact on ratepayers for any temporary rate increases, pending the completion of the full permanent rate setting process.

The request for the overall permanent rate increase was 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.

At this juncture, the case has been completed all the way through the final rate hearing at the NHPUC (which was held in public session on July 25, 2017), and is just awaiting final approval

of a filed public Settlement Agreement between the parties, and the issuance of a final Rate Order. It is anticipated that a final order will be forthcoming in the next 30-60 days. The actual rate increases granted by the Commission are not yet determined and final, but will be at levels well below the requested levels indicated above.

Water Infrastructure and Conservation Adjustment (WICA)

On January 31, 2017, Pennichuck Water Works, Inc. filed a petition with the New Hampshire Public Utilities Commission (NHPUC) to approve a Water Infrastructure and Conservation Adjustment (WICA) surcharge to be effective June 1, 2017, approve proposed 2017 WICA projects, and preliminarily approve proposed 2018 WICA projects. This petition process is in a “suspended” state, as the results of the PWW Rate Case, if approved per the Settlement Agreement, would terminate the WICA program and replace it with a new program inclusive in those rates. The new program would be analogous to the WICA program, but would be eligible for all capital improvement projects and expenditures, not just certain main replacement projects. The new program, if approved in that rate order, will be called the Qualified Capital Project Adjustment Charge (QCPAC), and would be subject to ongoing and annual filings and compliancy with the NHPUC.

Financing

On June 8, 2017, 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 \$2,400,000 for a 20-year term at an interest rate of 1.96%. The loan will fund the installation of a Merrimack River crossing interconnection pipeline connecting the distribution main owned by Pennichuck Water Works, Inc. in the Town of Merrimack to the existing Pennichuck East Utility, Inc. distribution system in the Town of Litchfield.

On June 8, 2017, 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 \$570,000 for a 30-year term at an interest rate of 1.96%. The loan will fund the replacement of approximately 2,400 linear feet of water main on Brady Avenue in the Maple Hills Community Water System in Derry, NH.

On June 8, 2017, 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 \$245,000 for a 20-year term at an interest rate of 1.96%. The loan will fund the replacement of approximately 1,200 linear feet of water main on Hillcrest Road in Litchfield, NH.

Educational Programs

The Company provided tours of the Water Treatment Plant to 4th grade students during Water Week in May. The Company provided a watershed protection program to 5th grade students in the Nashua School District and the Amherst School District and sponsored a poster contest for the students.