



**PENNICHUCK®**

**Pennichuck Corporation**

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

**Quarter Ended September 30, 2018**

### **Executive Summary**

- Revenues for the third quarter of 2018 were 8.7% higher than the prior year (\$13.8 million for 2018 versus \$12.7 million for 2017). Revenues on a year-to-date basis were 10.9% higher than last year (\$34.6 million for the nine months in 2018 versus \$31.2 million in 2017). These increases are due to (1) a Pennichuck Water Works, Inc. Permanent and Step increase totaling 10.81% which was approved on November 7, 2017 by the New Hampshire Public Utilities Commission (NHPUC) on Order No. 26,070, (2) a Pennichuck East Utility, Inc. temporary rate increase of 12.24% which was approved by the NHPUC on Order No. 26,136 and which became effective as of May 31, 2018, (3) a slight increase in overall consumption for the regulated utilities year-over-year, and (4) increases in overall revenues experienced by the service company with the loss of one large service contract and the addition of a new significant service contract, coupled with increases in unplanned revenue activities.
- Operating Income for the third quarter of 2018 was 5.4% higher than the prior year (\$3.9 million for 2018 versus \$3.7 million for 2017). Operating Income on a year-to-date basis was 22.9% higher than the prior year (\$5.9 million for 2018 versus \$4.8 million for 2017). Both of these variances are almost exclusively attributable to the increased revenue levels year-over-year.
- Pre-Tax Income for the third quarter of 2018 was \$1.2 million versus \$1.0 million for 2017. On a year-to-date basis, the pre-tax loss was \$2.2 million for 2018 versus pre-tax loss of \$3.3 million for 2017.
- Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA) for the third quarter of 2018 was 5.4% higher than the prior year (\$5.9 million in 2018 versus \$5.6 million for 2017). On a year-to-date basis, EBITDA was \$11.9 million for 2018 versus \$10.6 million for 2017.
- During the quarter, the Company paid approximately \$2.1 million to the City in principal, interest and dividends to fund the City Acquisition Debt. Year-to-date, the Company has paid approximately \$6.4 million to the City in principal, interest and dividends to fund the City Acquisition Debt.
- Capital expenditures for the third quarter of 2018 were \$4.7 million compared to \$2.7 million in the third quarter of 2017. On a year-to-date basis, capital expenditures for 2018 were \$6.9 million compared to \$5.0 million in 2017. The increase in activity year-over-year can be attributed mainly to the Pennichuck Water Works, Inc. / Pennichuck East Utility, Inc. Interconnection project, which involves the installation of almost 6,000 linear feet of large diameter water main beneath the Merrimack River, to address supply demands in the Litchfield and Hudson water systems, as well as other Pennichuck East water systems served on the east side of the river.

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 2018 as compared to the third quarter of 2017, and the nine months of 2018 as compared to the nine months of 2017, are as follows:

	(000’s)			
	<u>Quarter Ended</u>		<u>Year-to-Date</u>	
	<u>September 30, 2018</u>	<u>September 30, 2017</u>	<u>September 30, 2018</u>	<u>September 30, 2017</u>
Revenues				
Regulated Utilities	\$ 13,110	\$ 11,915	\$ 31,946	\$ 28,743
Other	<u>693</u>	<u>794</u>	<u>2,640</u>	<u>2,502</u>
Total	\$ 13,803	\$ 12,709	\$ 34,586	\$ 31,245
Operating Expenses				
Regulated Utilities	\$ 9,262	\$ 8,209	\$ 26,123	\$ 23,880
Other	<u>640</u>	<u>789</u>	<u>2,567</u>	<u>2,557</u>
Total	\$ 9,902	\$ 8,998	\$ 28,690	\$ 26,437
Operating Income	\$ 3,901	\$ 3,711	\$ 5,896	\$ 4,808
Non-Operational Income (Expense)	61	(1)	58	(3)
Net Interest Expense	<u>(2,785)</u>	<u>(2,744)</u>	<u>(8,143)</u>	<u>(8,126)</u>
Pre-Tax Income (Loss)	\$ 1,177	\$ 966	\$ (2,189)	\$ (3,321)
Income Tax Benefit (Expense)	<u>(875)</u>	<u>(537)</u>	<u>136</u>	<u>427</u>
Net Income (Loss)	\$ 302	\$ 429	\$ (2,053)	\$ (2,894)
Earnings Before Interest, Taxes, Depreciation and Amortization	\$ <u>5,920</u>	\$ <u>5,646</u>	\$ <u>11,936</u>	\$ <u>10,608</u>

Revenues from the water utility operations increased 10.1% in the quarter and 11.1% on an annual basis versus last year. Revenues include actual billed amounts through and including the September billing cycles, plus an accrual of unbilled amounts through the end of that month (based upon trailing consumption patterns). Revenues from the unregulated water service business have decreased 12.7% in the third quarter as compared to the third quarter of last year, primarily due to the June 30, 2018 expiration and non-renewal of the Town of Hudson service contract. On a year-to-date basis, the unregulated water service overall revenues are up by 4.0%

due to the addition of the Penacook-Boscawen contract in April 2018, coupled with increases in unplanned revenues, which have offset the non-renewal of the Town of Hudson contract.

Operating Expenses have increased approximately 10.0% in the third quarter and 8.7% on a year-to-year basis. The increase is mainly attributable to increased direct operating costs associated with increases in real estate taxes, labor costs and health insurance costs.

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

Interest Expense increased slightly in the third quarter by 3.7%, as compared to the third quarter of last year; year-to-date versus last year it has increased 0.2%, 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 third quarter pre-tax income and year-to-date pre-tax loss for 2018 compare positively to the pre-tax levels for 2017 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 16.2% versus the statutory rate benefit of 27.24% 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 increased revenues which offset the increased operating expenses and the slightly higher interest expense levels than 2017.

	(000's)	
<b><u>Balance Sheet</u></b>	As of <u>September 30, 2018</u> (Unaudited)	As of <u>December 31, 2017</u> (Audited)
<b><u>Assets</u></b>		
Property, Plant & Equipment, Net	\$ <u>213,215</u>	\$ <u>210,498</u>
Current Assets:		
Cash	1,173	994
Restricted Cash	6,096	4,953
Restricted Cash – Bond Project Funds	9	3,288
Accounts Receivable <sup>Note 1</sup>	7,833	5,699
Inventory	591	604
Other Current Assets <sup>Note 2</sup>	<u>1,375</u>	<u>2,257</u>
Total Current Assets	<u>17,077</u>	<u>17,795</u>
Other Assets:		
Acquisition Premium	71,759	73,227
Other Assets	<u>12,896</u>	<u>13,271</u>
Total Other Assets	<u>84,655</u>	<u>86,498</u>
TOTAL ASSETS	\$ <u>314,947</u>	\$ <u>314,791</u>
<b><u>Shareholder's Equity and Liabilities</u></b>		
Shareholder's Equity	\$ <u>11,747</u>	\$ <u>13,905</u>
Bonds, Notes and Mortgages	<u>200,710</u>	<u>197,905</u>
Current Liabilities:		
Line of Credit <sup>Note 3</sup>	4,458	5,574
Current Portion of Long-Term Debt	5,935	5,575
Other Current Liabilities <sup>Note 4</sup>	<u>4,315</u>	<u>4,292</u>
Total Current Liabilities	<u>14,708</u>	<u>15,441</u>
Other Long-Term Liabilities:		
CIAC, net	47,938	47,458
Deferred Income Taxes	12,816	12,847
Accrued Pension Liability <sup>Note 5</sup>	9,671	9,792
Other Long-Term Liabilities	<u>17,357</u>	<u>17,443</u>
Total Other Long-Term Liabilities	<u>87,782</u>	<u>87,540</u>
TOTAL SHAREHOLDER'S EQUITY AND LIABILITIES	\$ <u>314,947</u>	\$ <u>314,791</u>

### Notes to Balance Sheet

Note 1 (Accounts Receivable) – During the nine months of 2018, the balance in Accounts Receivable increased approximately \$2,134,000 from the year-end total at December 31, 2017 of \$5,699,000. This is mainly attributed to the revenue increases generated at the Regulated Utilities from the NHPUC approvals of the permanent and step increases for Pennichuck Water Works, Inc. in late 2017, and the temporary rate increase for Pennichuck East Utility, Inc. in May 2018. Slight consumption increases at the regulated utilities were contributing factors as well.

Note 2 (Other Current Assets) – At September 30, 2018, the balance of \$1,375,000 represents a reduction of \$882,000 from the end of 2017, mainly due to the \$1.1 million expensing of prepaid property taxes in the first quarter of 2018.

Note 3 (Line of Credit) – As of December 31, 2017, approximately \$5,574,000 was borrowed and outstanding under the Company’s Line of Credit in existence at that date. That balance was completely paid off on April 4, 2018 from the proceeds brought into the Company by the issuance of bonds by Pennichuck Water Works, Inc. These bonds were issued as a reimbursement of capital expenditures funded by working capital and Line of Credit borrowing during 2017.

In April of 2018, that Line of Credit, which had a \$6 million limit for borrowings was replaced by a new \$4 million Working Capital Line of Credit, and two new Fixed Asset Lines of Credit for Pennichuck Water Works, Inc. (\$10 million FALOC) and Pennichuck East Utility, Inc. (\$3 million FALOC), to be used to fund Construction Work in Progress on capital projects, which will be refinanced into long term debt term loan obligations or issued bond indebtedness, annually. The balance outstanding under the Company’s new Working Capital Line of Credit for Pennichuck Corporation was \$1,629,000 as of September 30, 2018. Additionally, as of that date, the balance outstanding on the two Fixed Asset Lines of Credit were \$2,811,000 for Pennichuck Water Works, Inc., and \$18,000 for Pennichuck East Utility, Inc. respectively.

Note 4 (Other Current Liabilities) – At December 31, 2017, approximately \$1,625,000 of this balance was comprised of accrued interest. 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. The balance in accrued interest for these financed amounts as of September 30, 2018 is \$797,000.

Note 5 (Accrued Pension Liability) – During the nine months of 2018, \$860,000 was contributed into the Pension Plan, while approximately \$484,000 in benefit payments were made to participants and approximately \$68,000 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 2018 as compared to the third quarter of 2017, and the year-to-date 2018 versus 2017, are as follows:

	(000's)			
	Quarter Ended		Year-to-Date	
	September 30,	September 30,	September 30,	September 30,
	2018	2017	2018	2017
Operating Activities:				
Net Income (Loss)	\$ <u>302</u>	\$ <u>429</u>	\$ <u>(2,053)</u>	\$ <u>(2,894)</u>
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by Operating Activities:				
Depreciation and Amortization	2,022	1,937	6,042	5,804
Provision for Deferred Taxes	884	550	(110)	(386)
Other	(18)	(10)	(37)	(55)
Changes in Assets and Liabilities:				
(Increase) Decrease in Accounts Receivable	(1,038)	(753)	(2,135)	(634)
(Increase) Decrease in Inventory	(13)	62	13	74
(Increase) Decrease in Other Assets	1,254	977	745	1,101
Increase (Decrease) in Accounts Payable	(987)	151	304	(2,542)
Increase (Decrease) in Other Liabilities	<u>1,046</u>	<u>295</u>	<u>(348)</u>	<u>(1,483)</u>
Net Cash Provided by (Used in) Operating Activities	<u>3,452</u>	<u>3,638</u>	<u>2,421</u>	<u>(1,015)</u>
Investing Activities:				
Purchases of Property, Plant & Equipment, including the Debt Component of AFUDC	(4,851)	(2,460)	(7,219)	(5,075)
Proceeds from Sale of Property, Plant & Equipment	-	-	-	37
(Increase) Decrease in Restricted Cash	-	(679)	-	7,130
Sale of Investment Securities	-	-	-	-
Change in Deferred Land Costs	<u>(3)</u>	<u>-</u>	<u>(19)</u>	<u>-</u>
Net Cash Provided by (Used in) Investing Activities	<u>(4,854)</u>	<u>(3,139)</u>	<u>(7,238)</u>	<u>2,092</u>
Financing Activities:				
Borrowings (Repayments) on Line of Credit	3,738	278	(1,116)	278
Payments on Long-term Debt	(875)	(778)	(4,728)	(4,406)
Contributions in Aid of Construction	319	-	400	18
Proceeds from Long-term Borrowings	1,390	64	8,087	1,503
Debt Issuance Costs	-	6	426	21
Dividends Paid	<u>(70)</u>	<u>(70)</u>	<u>(210)</u>	<u>(209)</u>
Net Cash Provided by (Used in) Financing Activities	<u>4,502</u>	<u>(500)</u>	<u>2,859</u>	<u>(2,795)</u>
Increase (Decrease) in Cash and Cash Equivalents	3,100	(1)	(1,958)	(1,718)
Cash and Cash Equivalents at Beginning of Period	<u>4,178</u>	<u>729</u>	<u>9,236</u>	<u>2,446</u>
Cash and Cash Equivalents at End of Period	\$ <u>7,278</u>	\$ <u>728</u>	\$ <u>7,278</u>	\$ <u>728</u>

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

### **Capital Expenditures**

Capital Expenditures in the third quarter of 2018 were \$4.7 million as compared to \$2.7 million in the third quarter of 2017. Capital Expenditures for the year-to-date were \$6.9 million as compared to \$5.0 million in 2017.

Major expenditures in the nine months of 2018 included:

PWW-PEU Merrimack River Interconnection	\$ 2,509,000
Main Replacement: Main Street Area, Phase 2, Nashua	\$ 644,000
Main Replacement: Factory Street, Nashua	\$ 357,000
Main Replacement: Brady Avenue, Derry	\$ 316,000
Meter Replacements	\$ 277,000
Main Replacement: Marshall Street, Nashua	\$ 222,000
Asset Management and GIS System	\$ 206,000

### **Rate Case - Pennichuck East Utility, Inc.**

On October 18, 2017, Pennichuck East Utility, Inc. (PEU) filed a request with the New Hampshire Public Utilities Commission (NHPUC) for a rate increase of 20.78% over its current rates for the test year 2016, for which 19.36% of this increase is related to a permanent rate increase and 1.42% 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. As a part of this overall rate setting process, PEU entered into a settlement agreement with the NHPUC staff and the OCA staff, requesting a temporary rate increase of 12.24% be granted as a subset of the final permanent rate increase, with the intention that this temporary rate increase would be approved in early 2018, and with permanent rates being set in the summer or fall of 2018.

The last general rate increase for PEU was in 2014, based upon 2012 as a test year. Since then, PEU's operating expenses have increased ratably, and for some items like local property taxes, well above the rate of inflation. Additionally, since the beginning of 2013, the Company has borrowed and invested over \$7.5 million in new capital assets to serve its customers through ongoing investments in infrastructure replacements and system improvements. The rate increase being requested would allow PEU to pay the debt service attributable to these new capital investments, pay its necessary operating costs, and continue to meet the needs of its customers.

On May 31, 2018, the NHPUC issued Order No. 26,136 approving the requested 12.24% increase in temporary rates effective on a bills-rendered basis as of January 8, 2018.



On October 4, 2018, the NHPUC issued Order No. 26,179 approving an overall permanent rate increase of 17.86%, inclusive of the 12.24% increase in temporary rates previously approved on May 31, 2018 on a bills-rendered basis as of January 8, 2018. This overall rate increase also includes a 1.43% Step increase earned on a forward-looking basis for bills rendered on or after November 16, 2018.

In addition to the rate increases granted in the order, the NHPUC approved the following modifications to PEU's rate structure:

- the creation of a Revenue Requirement (OERR) structure as adopted for Pennichuck Water Works, Inc. in 2017;
- the establishment of dedicated Rate Stabilization Funds (RSFs) in support of the OERR structure; and
- the establishment of a QCPAC (Qualified Capital Project Annual Adjustment Charge) that will assess annual surcharges between rate cases for capital expenditures placed in service in the prior year to fund the annual principal and interest payments of the associated new debt, in addition to the incremental property taxes associated with that capital.

#### **Qualified Capital Project Adjustment Charge (QCPAC)**

On November 7, 2017, the NHPUC issued Order No. 26,070 which approved replacement of the Pennichuck Water Works, Inc. (PWW) current WICA program with an annual QCPAC, which will apply an annual surcharge between rate cases. This surcharge will be based on essentially all of the capital projects undertaken and completed by PWW each year. The QCPAC is stipulated to include the full debt service (principal and interest), as well as the incremental property taxes, for annual additions to capital assets.

On October 29, 2018, the NHPUC issued Nisi Order No. 26,183 approving a 1.69% surcharge on all capital improvements completed and placed in service by PWW in 2017. This surcharge will go into effect in December of this year, on a going forward basis, as a subset of PWW's next allowed permanent rate increase.

#### **Financing- Pennichuck East Utility, Inc.**

On August 28, 2018, Pennichuck East Utility, Inc. filed a petition with the New Hampshire Public Utilities Commission (NHPUC) for approval to borrow \$4,240,000 for a 30-year term from the State of New Hampshire's Drinking Water Revolving Loan Fund Program, to be used to finance the cost of the Locke Lake New Groundwater Source project in Barnstead, NH. The financing has been approved by the Pennichuck Corporation and the Pennichuck East Utility, Inc. Boards of Directors, and by the City of Nashua, as sole shareholder of Pennichuck Corporation.

On November 6, 2018, the NHPUC issued Order No. 26,189 approving this financing. The Company will be closing on this financing before the end of 2018, with the funds being used for this project during 2019 and 2020.

**Financing-Pennichuck Water Works, Inc.**

On August 29, 2018, Pennichuck Water Works, Inc. filed a petition with the NHPUC for approval to borrow \$3,375,000 for a 30-year term from the State of New Hampshire's Drinking Water and Groundwater Trust Fund, to be used to finance the cost of the Pennichuck Core Water Main Replacement project. The financing has been approved by the Pennichuck Corporation and the Pennichuck Water Works, Inc. Boards of Directors, and by the City of Nashua, as sole shareholder of Pennichuck Corporation. The approval from the NHPUC for this financing is still in pendency as of this date.