



March 25, 2019

ANNUAL REPORT TO THE SOLE SHAREHOLDER

Dear Shareholder:

The Annual Meeting of Pennichuck Corporation will be held at 9:00 a.m. on Saturday, May 4, 2019 at the DoubleTree by Hilton, 2 Somerset Parkway, Nashua, New Hampshire.

Background on the City's Acquisition and Our Corporate Structure. The City's acquisition of the shares of Pennichuck Corporation was completed on January 25, 2012. As part of the acquisition, the corporate structure of Pennichuck Corporation and its subsidiaries was retained. Under the structure, the City of Nashua is the sole shareholder of Pennichuck Corporation. Under the Company's By-Laws, the City in its capacity as shareholder makes its decisions through actions by its Board of Aldermen, in accordance with the City's Charter. No single person – the Mayor or any individual member of the Board of Aldermen – is him or herself a shareholder; rather, the entity of the City itself is the sole shareholder of Pennichuck Corporation represented by the Board of Aldermen and the Mayor.

Pennichuck continues to own five corporate subsidiaries, including three regulated utilities (Pennichuck Water Works, Inc., Pennichuck East Utility, Inc., and Pittsfield Aqueduct Company, Inc.), an unregulated service company (Pennichuck Water Service Corporation), and a real estate holding company (The Southwood Corporation).

As unanimously approved by the City's Board of Aldermen at the time of the acquisition, the corporate structure was retained for several reasons.

First, the City's Mayor and Board of Aldermen desired to maintain some stability and continuity for all of the customers and employees of the Pennichuck companies. Retaining the existing corporate structure minimized the need for any radical changes to the utility companies and operations and encouraged support by all of the communities served by the utilities.

Second, retaining the corporate structure provided continuity for the regulatory and financial status of the companies and their respective businesses. The New Hampshire Public Utilities Commission continues to provide regulatory oversight for the utility companies, and banks, lenders and other contract parties continue to be able to rely on existing contracts and other rules with respect to financing and other operations.

Third, the Mayor and Board of Aldermen unanimously agreed to establish a corporate governance system for the purposes of managing Pennichuck Corporation. This corporate

governance system relies upon well-established principles of corporate law, and is established pursuant to Pennichuck Corporation's Articles of Incorporation and By-Laws, as adopted by the City and the Company at the time of the acquisition pursuant to the Merger Agreement.

This well-known corporate governance model, which incorporates well-established principles regarding fiduciary obligations of board members, was structured to provide assurances to the City's rating agencies, potential lenders, the New Hampshire Public Utilities Commission and the many communities we serve that decisions are based on sound business and financial analysis, and in a manner that minimizes political considerations.

Operations, Communities and Customers. Our companies provide water service to a wide range of communities and customers.

Pennichuck Water Works, Inc. provides water service to approximately 28,750 customers in 11 communities which include Amherst, Bedford, Derry, Epping, Hollis, Merrimack, Milford, Nashua, Newmarket, Plaistow and Salem.

Pennichuck East Utility, Inc. provides water service to approximately 8,100 customers in 19 communities which include Atkinson, Barnstead, Bow, Chester, Conway, Derry, Exeter, Hooksett, Lee, Litchfield, Londonderry, Middleton, Pelham, Plaistow, Raymond, Sandown, Tilton, Weare and Windham.

Pittsfield Aqueduct Company, Inc. provides water service to approximately 640 customers in Pittsfield.

Pennichuck Water Service Corporation provides service in connection with the management of water operations services for 2 communities; water operations, billing, collection and customer services for 2 communities; billing services for 4 communities; and water meter testing services, as well as contracted water services at various levels, for approximately 64 small independently owned water systems.

The Southwood Corporation owns various parcels of land in the Town of Merrimack.

The Company's mission is to be a premier supplier of water in New Hampshire by providing reliable, high quality and affordable water in sufficient quantities, and be New England's premier supplier of water related contract services by providing high quality solutions to meet our customers' needs.

Strategies supporting the corporate mission have been developed relative to our water resources, employees, financing, customer services and Company assets. These strategies are available on the Company's website, www.pennichuck.com, under the "Management and Financial Information" caption, and the sub-caption of "Strategic Plan."

The Company currently has 124 employees. The employees are committed to supporting the Company's mission. Each of our managers has goals and objectives to support the strategies supporting the mission. Pennichuck is an Equal Opportunity/Affirmative Action Employer. It is the policy of the Company to hire, train, promote, and otherwise provide terms and conditions of employment without regard to race, color, religion, sex, sexual orientation, gender identity,

national origin, ancestry, age, marital status, pregnancy, disability or veteran status. All employment and promotion decisions are based solely on valid requirements, in accordance with the principles of equal employment opportunity and affirmative action.

Financial Performance During the Last Year. The Company's audited consolidated financial statements for the year ended December 31, 2018 are attached to this report.

	(\$ Millions)			
	4 th Quarter		Year-to-Date	
	2018	2017	2018	2017
Revenues	\$10.7	\$ 9.7	\$ 45.3	\$ 40.9
Operating Expenses	(9.4)	(9.0)	(38.1)	(35.4)
Operating Income	1.3	0.7	7.2	5.5
Interest Expense	(2.8)	(2.7)	(10.9)	(10.8)
Other Income	-	-	-	-
Pre-Tax Income (Loss)	(1.5)	(2.0)	(3.7)	(5.3)
Income Tax Provision (Benefit)	1.7	1.5	1.6	1.1
Net Income (Loss)	(3.2)	(3.5)	(5.3)	(6.4)
Dividends Paid to the Shareholder	0.1	0.1	0.3	0.3
Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)	3.5	2.7	15.4	13.3

- Consolidated revenues for the fourth quarter increased by \$1.0 million from \$9.7 million in 2017 to \$10.7 million in 2018. The increase is primarily attributable to the October 4, 2018 PUC Order No. 26,179 for Pennichuck East Utility, Inc. which approved an overall permanent rate increase of 17.86%, which already included a temporary rate increase of 12.24%, which was approved on May 31, 2018 as a subset of the new permanent rates, and a 1.43% step increase earned on a forward-looking basis for bills-rendered on or after November 16, 2018.
- Consolidated year-to-date revenues increased from \$40.9 million in 2017 to \$45.3 million in 2018, an increase of 10.8%. Revenues from the regulated utilities increased primarily due to: (1) the full-year impact of the Pennichuck Water Works, Inc. Permanent and Step increase which was approved on November 7, 2017, totaling 10.81%, by the New Hampshire Public Utilities Commission (NHPUC) on Order No. 26,070, (2) the Pennichuck East Utility, Inc. permanent rate increase of 17.86%, described in detail in the preceding paragraph, and (3) the Service Company experiencing increases in overall revenues despite the loss of one large service contract at the end of June 2018, which was offset by the addition of another new significant service contract in early 2018, in addition to increases in unplanned revenue activities for a number of the operating contracts during the year.
- Consolidated operating expenses increased by \$0.4 million for the fourth quarter of 2018, over the same quarter in 2017. The increase is primarily related to labor related costs, inflationary increases, higher maintenance related costs, production costs, and higher depreciation costs associated with ongoing capital investments.

- Consolidated operating expenses increased by \$2.7 million, or 7.6%, for the full year, from 2017 to 2018, mainly due to higher maintenance related costs, production costs, increased depreciation costs, and labor related costs.
- Interest expense increased slightly in 2018 when compared to 2017 due to 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.
- Pre-tax loss for the fourth quarter decreased to \$1.5 million in 2018 versus \$2.0 million in 2017, due to the increase in revenues which was offset by increased operating expenses, primarily maintenance and production related, and depreciation costs, year-over-year.
- The pre-tax loss for the year decreased from \$5.3 million in 2017 to \$3.7 million in 2018, or 30.2%, due to the \$4.4 million in increased revenues discussed previously, offset by the increased operating costs year-over-year, which resulted in the lower pre-tax loss in 2018.
- Dividends paid to the sole shareholder in both 2018 and 2017 were consistent with, and were paid pursuant to, the CBFRR structure provided for in the New Hampshire Public Utilities Commission's Order approving the City's ownership of the Company.
- The Income Tax Provision in the current year reflects the tax accounting for the amortization of the Municipal Acquisition Regulatory Asset, which is not deductible for tax purposes, and as such, constitutes a permanent difference in the deductibility of those amortization expenses for tax purposes, as opposed to their inclusion in the GAAP based financial statements. The Income Tax Provision (Benefit) also reflects the taxation of CIAC as income for Regulated Water Utilities, due to the elimination of an exemption allowed prior to the passage of the *2017 Tax Cuts and Jobs Act* ("TCJA") which made broad and complex changes to the U.S. tax code. A tariff change request is in process with the NH Public Utilities Commission, requesting the implementation of a "gross up" component related to this newly taxable element of the Company's ongoing business operations, in order to mitigate further impacts of the TCJA for this item going forward, as it relates to rate payer shared costs. Due to these two significant items, the year-to-date results reflect a tax provision of approximately -47.1% of pre-tax income for 2018, compared to the statutory tax rate expense of 27.24%.
- Earnings Before Interest, Taxes, Depreciation and Amortization increased in the fourth quarter from \$2.7 million in 2017 to \$3.5 million in 2018, or 29.6%, due to increased revenues as discussed previously, offset by operating expense variations (excluding interest).
- Earnings Before Interest, Taxes, Depreciation and Amortization for 2018 increased from 2017 by approximately \$2.1 million, or 15.8%, again due to higher revenues earned year-over-year, offset by operating expense increases, excluding interest expense.

Unaudited Cash Flow Statement

Cash Flow on a GAAP basis for the fourth quarter of 2018 as compared to the fourth quarter of 2017, and the year-to-date 2018 versus 2017, are as follows:

	(\$000's)			
	Quarter Ended		Year-to-Date	
	December 31, 2018	December 31, 2017	December 31, 2018	December 31, 2017
Operating Activities:				
Net Income (Loss)	\$ (3,229)	\$ (3,547)	\$ (5,282)	\$ (6,441)
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by Operating Activities:				
Depreciation and Amortization	2,154	2,034	8,196	7,838
Provision for Deferred Taxes	1,316	(7,668)	1,206	(8,054)
(Gain) on Disposition of Property	(115)	(31)	(115)	(31)
Other	(17)	14	(54)	(41)
Changes in Assets and Liabilities:				
(Increase) Decrease in Accounts Receivable	1,486	1,021	(649)	387
(Increase) Decrease in Inventory	(20)	(12)	(7)	62
(Increase) Decrease in Other Assets	(951)	(1,977)	(206)	(876)
Increase (Decrease) in Accounts Payable	3,513	(2,213)	3,817	(4,755)
Increase (Decrease) in Other Liabilities	1,458	11,131	1,110	9,648
Net Cash Provided by (Used in) Operating Activities	5,595	(1,248)	8,016	(2,263)
Investing Activities:				
Purchases of Property, Plant & Equipment, including the Debt Component of AFUDC	(6,571)	(2,617)	(13,790)	(7,692)
(Increase) Decrease in Restricted Cash/Investments	0	0	0	0
Proceeds from Sale of Property	119	-	119	37
Change in Deferred Land Costs	0	(8)	(19)	(8)
Net Cash Provided by (Used in) Investing Activities	(6,452)	(2,625)	(13,690)	(7,663)
Financing Activities:				
Borrowings (Repayments) on Line of Credit	2,168	5,296	1,052	5,574
Payments on Long-term Debt	(886)	(803)	(5,614)	(5,209)
Contributions in Aid of Construction	296	18	696	36
Proceeds from Long-term Borrowings	406	972	8,493	2,475
Debt Issuance Costs	5	-	431	21
Dividends Paid	(70)	(70)	(280)	(279)
Net Cash Provided by (Used in) Financing Activities	1,919	5,413	4,778	2,618
Increase (Decrease) in Cash and Cash Equivalents	1,062	1,540	(896)	(7,308)
Cash and Cash Equivalents at Beginning of Period	7,278	7,696	9,236	16,544
Cash and Cash Equivalents at End of Period	\$ 8,340	\$ 9,236	\$ 8,340	\$ 9,236

Balance Sheet

(\$000's)

	As of December 31, 2018 (Audited)	As of December 31, 2017 (Audited)
Assets		
Property, Plant & Equipment, Net	\$ <u>221,860</u>	\$ <u>210,498</u>
Current Assets:		
Cash	1,575	994
Restricted Cash	3,428	4,954
Investments – Bond Project Funds	3,337	3,288
Accounts Receivable	6,348	5,698
Inventory	611	604
Other Current Assets ^{Note 1}	<u>1,631</u>	<u>2,257</u>
Total Current Assets	<u>16,930</u>	<u>17,795</u>
Other Assets:		
Acquisition Premium ^{Note 2}	71,268	73,227
Other Assets	<u>13,075</u>	<u>13,271</u>
Total Other Assets	<u>84,343</u>	<u>86,498</u>
TOTAL ASSETS	\$ <u>323,133</u>	\$ <u>314,791</u>
Shareholders' Equity and Liabilities		
Shareholders' Equity	\$ <u>8,410</u>	\$ <u>13,905</u>
Bonds, Notes and Mortgages	<u>200,225</u>	<u>197,905</u>
Current Liabilities:		
Line of Credit	6,626	5,574
Current Portion of Long-Term Debt	6,019	5,575
Other Current Liabilities	<u>8,388</u>	<u>4,292</u>
Total Current Liabilities	<u>21,033</u>	<u>15,441</u>
Other Long-Term Liabilities:		
CIAC, net	51,961	47,458
Deferred Income Taxes	14,110	12,847
Accrued Pension Liability ^{Note 3}	10,021	9,792
Other Long-Term Liabilities	<u>17,373</u>	<u>17,443</u>
Total Other Long-Term Liabilities	<u>93,465</u>	<u>87,540</u>
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES	\$ <u>323,133</u>	\$ <u>314,791</u>

Notes to Balance Sheet

Note 1 (Other Current Assets) – At December 31, 2018, approximately \$1.0 million of this balance is comprised of prepaid property taxes, which will be expensed in the first quarter of 2019, relating to taxes paid in November and December of 2018 for the second half of the property tax year ended March 31, 2019.

Note 2 (Acquisition Premium) – In accordance with GAAP, the Acquisition Premium is being written-off over the 30-year life of the principal of the City Acquisition Debt.

Note 3 (Accrued Pension Liability) – During 2018, approximately \$1.1 million was contributed into the Pension Plan, while approximately \$.6 million in benefit payments were made to participants, and approximately \$.9 million of investment losses were recorded, attributed to changes in market values.

Capital Expenditures

Capital expenditures in the fourth quarter of 2018 were \$6.6 million compared to \$2.9 million in the fourth quarter of 2017. For the year 2018, capital expenditures were \$13.6 million as compared to \$8.0 million in 2017.

The major expenditures for 2018 were as follows:

PWW-PEU Interconnection	\$ 2,980,000
Kinsley St. Main Replacements	\$ 694,000
Taylor St. Main Replacements – Phase 2	\$ 651,000
Factory St. Main Replacements	\$ 603,000
Asset Management	\$ 387,000
Brady Ave./Maple Hills, Derry Main Replacements	\$ 372,000
Marshall St. Main Replacements	\$ 355,000
PWW-PEU Interconnection – Station Bidding & Const.	\$ 339,000
Meter Replacements	\$ 314,000

Rate Case - Pennichuck East Utility, Inc.

On October 18, 2017, Pennichuck East Utility, Inc. (“PEU”) filed a request with the 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 was 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 would 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, PEU requested that 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 increased ratably, and for some items like local property taxes, well above the rate of inflation. Additionally, since the beginning of 2013, the Company 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 now and into the future.

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 included a 1.43% Step increase earned on a forward-looking basis for bills rendered on or after November 16, 2018.

Qualified Capital Project Adjustment Charge (QCPAC)

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 Pennichuck Water Works, Inc. (PWW) in 2017. This surcharge went into effect in December 2018, on a going forward basis, as a subset of PWW's next allowed permanent rate increase.

Financing

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 was 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 loan closing was completed on February 12, 2019, with the funds to be drawn down for this project during the 2019 and 2020 calendar years.

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 was 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. On December 3, 2018, the NHPUC issued Order No. 26,197 approving this financing. The loan closing was completed on February 12, 2019, with the entire project scheduled to be completed within 2019.

Other Events

PFOA Contamination Issues

During 2016, the Company was significantly involved in assisting the New Hampshire Department of Environmental Services (“NHDES”) in assessing and bringing remediation solutions to bear, in light of the PFOA contamination issues discovered in the towns surrounding the Saint Gobain Performance Plastics (“SGPP”) site in north Merrimack. This included self-instituting comprehensive and regular testing of the Company’s water supplies and water systems, not only in the area adjacent to this site, but taking and processing at least two sets of tests at all water sources that the Company owns throughout the State. This was done in order to detect if any levels of contamination existed in the water sources, to aid the NHDES in completing their statewide assessment, and to allow the Company to respond with certainty to any of its customers as to any detectable levels. With regards to the water supply systems directly adjacent to or connected to the Merrimack Village District, the Company has been taking weekly or monthly samples since this contamination site was disclosed in March of 2016. The results of these tests were that none of the Company’s water sources had detectable levels exceeding EPA lifetime advisory levels, or the State’s emergency and impending permanent standard detection levels.

Additionally, at the request of the NHDES, the Company was asked to enter into a contract with SGPP for the design of the expansion of public water to residents in the northern portion of Litchfield, where private wells had been contaminated, in some cases well above acceptable levels. Based upon the results of that design work, the Company was then contracted by SGPP to expand the public water system owned by the Company in Litchfield to approximately 400 property owners, including nearly 10 miles of new water mains and nearly 10 miles of new service lines. The cost of the design work and the expansion of the water system has and is being paid totally by SGPP and was contributed to the Company as Contributions in Aid of Construction (CIAC), as assets to be owned by the Company, the Town, or the residents (in the case of the service lines) going forward.

Additionally, during 2018 the Company was asked by NHDES to contract for similar design services with SGPP for expansion of its public water system in southern Bedford. This project was initiated in 2018, and is slated for completion in the first half of 2019, bringing water to approximately 90 new customers in that community.

The Company was also asked by the NHDES to design a further buildout for SGPP in Litchfield to bring public water to an additional 30 residences in Litchfield, due to this contamination site. It is anticipated that SGPP will enter into another contract with the Company for the expansion of the Company’s water system in that area, construction of which would expect to begin in the Summer of 2019, and would be fully paid for by SGPP, and included in CIAC assets at such time as those projects were completed.

As of March 20, 2018, SGPP and NHDES entered into a Consent Decree, and as such, the Company is currently working with SGPP in the scheduling of these projects, including the construction management agreements tied to this activity. Under the Consent Decree, SGPP needs to fulfill their obligations by November 2019 on all of these currently identified activities.

A similar effort on behalf of Textiles Coated International, Inc. (“TCI”) in the town of Amherst, due to PFOA contamination related to their previous existence as a manufacturer in that town, was also undertaken at the request of the NHDES. The Company was contracted to do design services for the expansion of the public water system in that area of Amherst, by TCI, and construction of the expansion of that part of the system began in 2017, and was fully completed in 2018. Once again, the entire cost of this project was borne by TCI, and has become part of the Company’s owned infrastructure as CIAC assets.

Company Goals – 2019

The Company’s main goals for 2019 are as follows:

- File a PWW Rate Case for test year 2018, including a request for further rate structure modification relating to an annual surcharge for inflationary increases in operating expenses, and the inclusion of income taxes in recoverable operating expenses.
- File the initial PEU QCPAC case, as well as the annual PWW QCPAC case, for Capex investments placed in service during 2018.
- Research considerations of the effective usage of social media in customer relations and outreach.
- Complete design and approval of the Locke Lake (Barnstead) overflow intake and treatment facilities upgrades.
- Complete the installation and replacement of water mains during 2019 in the northwest portion of the PWW “core” distribution system, in preparation for the replacement of the Kessler Farm Tank in 2020.
- Continued development and implementation of the Asset Management, GIS and DPAC modules, including criticality and vulnerability assessment to establish a framework for 2020 Capex planning.
- Continued roll-out and implementation of the company-wide Customer Security Program, to the benefit and safety of customers and employees.
- Continued disposal of “excess” land portfolio, with additional lots to be swapped or placed on the market during 2019.
- Completion and ongoing response and action to PFOA contamination issues in Merrimack, Litchfield, Bedford and Amherst, in cooperation with the NHDES and other State agencies.
- Complete the design of a rebuild of the Bowers Dam, in preparation for a project to be completed in 2020.
- Work with NHDES in assessment and implementation of new State MCL’s for 1,4 dioxane, arsenic, PFAS and lead testing in schools.
- Complete Bond issuance reimbursement financing in April 2019, for PWW 2018 Capex.

- Implementation of the new Revenue Recognition standard (ASU No. 2014-09), including new accounting methodology and reporting.
- Complete the evaluation, design and negotiations relating to the potential move of the Company's headquarters facilities to a new location in the City during 2020.
- Continued participation in multiple educational outreach efforts within the Company's customer coverage radius.

Other detailed information is included in the Company's financial statements.

Sincerely,

A handwritten signature in blue ink, appearing to read 'L. Goodhue', is positioned above the printed name.

Larry D. Goodhue
Chief Executive Officer,
Chief Financial Officer
and Treasurer

Pennichuck Corporation and Subsidiaries
Consolidated Financial Statements
December 31, 2018 and 2017
(With Independent Auditors' Report Thereon)

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INDEPENDENT AUDITORS' REPORT

Board of Directors and Stockholder
Pennichuck Corporation and Subsidiaries

Additional Offices:
Nashua, NH
Andover, MA
Greenfield, MA
Ellsworth, ME

We have audited the accompanying consolidated financial statements of Pennichuck Corporation and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income (loss), comprehensive income (loss), changes in stockholder's equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pennichuck Corporation and Subsidiaries as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Melanson Heath

March 20, 2019

PENNICHUCK CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
As of December 31, 2018 and 2017
(in thousands, except share data)

	<u>2018</u>	<u>2017</u>
ASSETS		
Property, Plant and Equipment, net	\$ 221,860	\$ 210,498
Current Assets:		
Cash and cash equivalents	1,575	994
Restricted cash - RSF	3,428	4,953
Restricted cash - Bond Project Funds	3,337	3,288
Accounts receivable - billed, net	3,417	3,420
Accounts receivable - unbilled, net	2,927	2,265
Accounts receivable - other	4	14
Inventory	611	604
Prepaid expenses	610	598
Prepaid property taxes	1,021	1,143
Deferred and refundable income taxes	-	516
Total Current Assets	<u>16,930</u>	<u>17,795</u>
Other Assets:		
Deferred land costs	2,275	2,257
Deferred charges and other assets	10,697	10,911
Investment in real estate partnership	104	103
Acquisition premium, net	<u>71,268</u>	<u>73,227</u>
Total Other Assets	<u>84,344</u>	<u>86,498</u>
TOTAL ASSETS	<u><u>\$ 323,134</u></u>	<u><u>\$ 314,791</u></u>

The accompanying notes are an integral part of these consolidated financial statements.

PENNICHUCK CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS - CONTINUED

As of December 31, 2018 and 2017

(in thousands, except share data)

	<u>2018</u>	<u>2017</u>
STOCKHOLDER'S EQUITY AND LIABILITIES		
Stockholder's Equity:		
Common stock; \$0.01 par value; 1,000 shares authorized, issued and outstanding	\$ -	\$ -
Additional paid in capital	30,561	30,561
Accumulated deficit	(22,523)	(16,961)
Accumulated other comprehensive income	372	305
Total Stockholder's Equity	<u>8,410</u>	<u>13,905</u>
Long-Term Debt, Less Current Portion and Unamortized Debt Issuance Costs	<u>200,225</u>	<u>197,905</u>
Current Liabilities:		
Lines of credit	6,626	5,574
Current portion of long-term debt	6,019	5,575
Accounts payable	5,362	1,543
Accrued property taxes	-	115
Deferred revenue	63	66
Accrued interest payable	1,682	1,625
Other accrued expenses	700	394
Accrued wages and payroll withholding	346	358
Customer deposits and other	235	191
Total Current Liabilities	<u>21,033</u>	<u>15,441</u>
Other Liabilities and Deferred Credits:		
Deferred income taxes	14,110	12,847
Accrued pension liability	10,021	9,792
Unamortized debt premium	2,966	2,964
Deferred investment tax credits	470	504
Regulatory liability	9,943	9,955
Accrued post-retirement benefits	3,201	3,047
Customer advances	84	84
Contributions in aid of construction, net	51,961	47,458
Derivative instrument	263	374
Other long-term liabilities	447	515
Total Other Liabilities and Deferred Credits	<u>93,466</u>	<u>87,540</u>
TOTAL STOCKHOLDER'S EQUITY AND LIABILITIES	<u><u>\$ 323,134</u></u>	<u><u>\$ 314,791</u></u>

The accompanying notes are an integral part of these consolidated financial statements.

PENNICHUCK CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (LOSS)
For the Years Ended December 31, 2018 and 2017
(in thousands)

	<u>2018</u>	<u>2017</u>
Operating Revenues	\$ 45,265	\$ 40,893
Operating Expenses:		
Operations and maintenance	23,540	21,312
Depreciation and amortization	8,113	7,762
Taxes other than income taxes	<u>6,509</u>	<u>6,343</u>
Total Operating Expenses	<u>38,162</u>	<u>35,417</u>
Operating Income	7,103	5,476
Interest Expense	(10,910)	(10,833)
Allowance for Funds Used During Construction	106	27
Other, Net	<u>111</u>	<u>(3)</u>
Loss Before Provision for Income Taxes	(3,590)	(5,333)
Provision for Income Taxes	<u>(1,692)</u>	<u>(1,108)</u>
Net Loss	<u>\$ (5,282)</u>	<u>\$ (6,441)</u>

The accompanying notes are an integral part of these consolidated financial statements.

PENNICHUCK CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
For the Years Ended December 31, 2018 and 2017
(in thousands)

	<u>2018</u>	<u>2017</u>
Net Loss	\$ (5,282)	\$ (6,441)
Other Comprehensive Income (Loss):		
Unrealized gain on derivatives	53	3
Reclassification of net income realized in net income	59	76
Income tax benefit relating to other comprehensive income	<u>(45)</u>	<u>(32)</u>
Other Comprehensive Income	<u>67</u>	<u>47</u>
Comprehensive Loss	<u><u>\$ (5,215)</u></u>	<u><u>\$ (6,394)</u></u>

The accompanying notes are an integral part of these consolidated financial statements.

PENNICHUCK CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDER'S EQUITY
For the Year Ended December 31, 2018
(in thousands, except per share data)

	<u>Common Stock</u>		<u>Additional</u>	<u>Retained</u>	<u>Accumulated</u>	
	<u>Shares</u>	<u>Amount</u>	<u>Paid in</u>	<u>Earnings/(Deficit)</u>	<u>Other</u>	<u>Total</u>
			<u>Capital</u>		<u>Comprehensive</u>	
					<u>Income</u>	
Balance as of January 1, 2018	1,000	\$ -	\$ 30,561	\$ (16,961)	\$ 305	\$ 13,905
Common dividends declared	-	-	-	(280)	-	(280)
Net loss	-	-	-	(5,282)	-	(5,282)
Other comprehensive income:						
Unrealized gain on derivatives, net of taxes of \$21	-	-	-	-	32	32
Reclassification of net income realized in net income, net of taxes of \$24	-	-	-	-	35	35
Balance as of December 31, 2018	<u>1,000</u>	<u>\$ -</u>	<u>\$ 30,561</u>	<u>\$ (22,523)</u>	<u>\$ 372</u>	<u>\$ 8,410</u>

The accompanying notes are an integral part of these consolidated financial statements.

PENNICHUCK CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDER'S EQUITY
For the Year Ended December 31, 2017
(in thousands, except per share data)

	<u>Common Stock</u>		<u>Additional</u>	<u>Retained</u>	<u>Accumulated</u>	
	<u>Shares</u>	<u>Amount</u>	<u>Paid in</u>	<u>Earnings/(Deficit)</u>	<u>Other</u>	<u>Total</u>
			<u>Capital</u>		<u>Comprehensive</u>	
					<u>Income</u>	
Balance as of						
January 1, 2017	1,000	\$ -	\$ 30,561	\$ (10,241)	\$ 258	\$ 20,578
Common dividends declared	-	-	-	(279)	-	(279)
Net loss	-	-	-	(6,441)	-	(6,441)
Other comprehensive income:						
Unrealized gain on derivatives, net of taxes of \$1	-	-	-	-	1	1
Reclassification of net income realized in net income, net of taxes of \$31	-	-	-	-	46	46
Balance as of						
December 31, 2017	<u>1,000</u>	<u>\$ -</u>	<u>\$ 30,561</u>	<u>\$ (16,961)</u>	<u>\$ 305</u>	<u>\$ 13,905</u>

The accompanying notes are an integral part of these consolidated financial statements.

PENNICHUCK CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2018 and 2017
(in thousands)

	<u>2018</u>	<u>2017</u>
Operating Activities:		
Net Loss	\$ (5,282)	\$ (6,441)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation and amortization	8,196	7,838
Equity component of AFUDC	(20)	(9)
Amortization of deferred investment tax credits	(33)	(33)
Provision for deferred income tax	1,206	1,141
Undistributed (income) loss in real estate partnership	(1)	1
Gain on disposition of property	(114)	(31)
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable billed and unbilled	(649)	387
(Increase) decrease in inventory	(7)	62
(Increase) decrease in prepaid expenses	110	(46)
(Increase) decrease in deferred charges and other assets	550	(625)
(Increase) decrease in refundable income taxes	516	(164)
Increase (decrease) in accounts payable and deferred revenue	3,817	(4,429)
Increase (decrease) in accrued interest payable	57	(79)
Increase in other	534	205
Net cash provided (used) by operating activities	<u>8,880</u>	<u>(2,223)</u>
Investing Activities:		
Purchase of property, plant and equipment including debt component of allowance for funds used during construction	(13,790)	(7,716)
Proceeds from sale of property	119	37
Change in investment in real estate partnership and deferred land costs	<u>(19)</u>	<u>(8)</u>
Net cash used by investing activities	<u>(13,690)</u>	<u>(7,687)</u>

The accompanying notes are an integral part of these consolidated financial statements.

PENNICHUCK CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2018 and 2017
(in thousands)

	<u>2018</u>	<u>2017</u>
Financing Activities:		
Borrowings (payments) on lines of credit, net	\$ 1,052	\$ 5,574
Payments on long-term debt	(5,614)	(5,209)
Contributions in aid of construction	696	61
Proceeds from long-term borrowings	8,492	2,475
Debt issuance costs	(431)	(21)
Dividends paid	(280)	(279)
Net cash provided by financing activities	<u>3,915</u>	<u>2,601</u>
Increase (Decrease) in cash, cash equivalents, and restricted cash	(895)	(7,309)
Cash, cash equivalents, and restricted cash at beginning of period	<u>9,235</u>	<u>16,544</u>
Cash, cash equivalents, and restricted cash at end of period	<u><u>\$ 8,340</u></u>	<u><u>\$ 9,235</u></u>

Supplemental Disclosure on Cash Flow and Non-cash Items
For the Years Ended December 31, 2018 and 2017 (in thousands)

	<u>2018</u>	<u>2017</u>
Cash paid during the period for:		
Interest	\$ 10,645	\$ 10,706
Income taxes	141	167
Non-cash items:		
Contributions in aid of construction	4,962	8,072
Forgiveness of debt	87	77

The accompanying notes are an integral part of these consolidated financial statements.

PENNICHUCK CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Description of Business and Summary of Significant Accounting Policies

Description of Business:

Pennichuck Corporation (“the Company,” “we,” or “our”) is a holding company headquartered in Merrimack, New Hampshire with five wholly owned operating subsidiaries: Pennichuck Water Works, Inc., (“Pennichuck Water”) Pennichuck East Utility, Inc., (“Pennichuck East”) and Pittsfield Aqueduct Company, Inc. (“PAC”) (collectively referred to as our Company’s “utility subsidiaries”), which are involved in regulated water supply and distribution to customers in New Hampshire; Pennichuck Water Service Corporation (“Service Corporation”) which conducts non-regulated water-related services; and The Southwood Corporation (“Southwood”) which owns several parcels of undeveloped land.

The Company’s utility subsidiaries are engaged principally in the collection, storage, treatment and distribution of potable water to approximately 37,242 customers throughout the State of New Hampshire. The utility subsidiaries, which are regulated by the New Hampshire Public Utilities Commission (the “NHPUC”), are subject to the provisions of Accounting Standards Codification (“ASC”) Topic 980 “*Regulated Operations*.”

Summary of Significant Accounting Policies:

Basis of Presentation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation.

Use of Estimates in the Preparation of Consolidated Financial Statements

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Property, Plant and Equipment

Property, plant and equipment, which includes principally the water utility assets of the Company’s utility subsidiaries, is recorded at cost plus an allowance for funds used during construction on major, long-term projects and includes property funded with contributions in aid of construction.

Maintenance, repairs and minor improvements are charged to expense as incurred. Improvements which significantly increase the value of property, plant and equipment are capitalized.

Cash and Cash Equivalents

Cash and cash equivalents generally consist of cash, money market funds and other short-term liquid investments with original maturities of three months or less.

Restricted Cash – RSF

This restricted cash balance consists of funds maintained for the Rate Stabilization Fund (“RSF”), which was established in conformity with the requirements of NHPUC Order 25,292, as explained more fully in Note 13 of these financial statements. The RSF is an imprest fund of \$5 million, which is subject to funding above or below the imprest fund balance, reflecting actual revenue performance as it relates to prescribed revenue levels supported by the RSF. The excess or deficient amount (versus the \$5 million imprest balance) is subject to return or collection to rate payers over the succeeding three-year period of time, as of the rate order issued with the next promulgated rate case filing. On November 7, 2017, the NH PUC approved and issued Order No. 26,070 which established new rates for Pennichuck Water. In addition, the rate order then authorized the reallocation of the existing \$5,000,000 Rate Stabilization Fund among the Company’s three utilities. Such that, Pennichuck Water’s allocated share of the RSF would now be \$3,920,000, with the remaining balance of \$1,080,000 to be allocated between Pennichuck East and Pittsfield Aqueduct. Rate order No. 26,179, under docket DW 17-128 then allocated \$980,000 of the \$1,080,000 to Pennichuck East Utility with the remaining \$100,000 to Pittsfield Aqueduct. The purpose for splitting and allocating the existing RSF is to provide additional reserves which ensure sufficient capital to enable the Company to support its operations. For the years ending December 31, 2018 and 2017, the balances in the RSF were \$3.4 million and \$4.9 million, respectively.

Restricted Cash – Bond Project Funds

This restricted cash balance consists of funds remaining from the issuance of the Series 2014, 2015 and 2018 tax-exempt bonds (the “Bonds”) in December of 2014, October of 2015 and April of 2018, respectively. The proceeds from those bond issuance transactions are maintained in separate restricted cash accounts, with Trustee oversight, and are subject to withdrawal as a reimbursement of eligible capital project expenditures for the years 2014 through 2019, as defined by the indenture and issuance documents associated with each offering. The restricted cash accounts are also used as a “conduit” for the transfer of money from operating cash to restricted cash, allowing the Trustee to make the required payments to bondholders for principal and interest due semi-annually.

As of December 31, 2017, the funds in these restricted cash accounts totaled approximately \$3.3 million. During 2018, approximately \$3.3 million was withdrawn from the restricted cash accounts to make the principal and interest payments for the Bonds, on January 1, July 1 and October 1. In December 2018, approximately \$3.3 million was transferred into these restricted cash accounts from the Company’s operating cash accounts, to provide the funds needed to make the net principal and interest payments due on January 1, 2019 for the Bonds. As of December 31, 2018, the funds in these restricted cash accounts totaled approximately \$3.3 million.

Concentration of Credit Risks

Financial instruments that subject the Company to credit risk consist primarily of cash (including cash equivalents and restricted cash) and accounts receivable. Cash balances are invested in financial institutions insured by the Federal Deposit Insurance Corporation ("FDIC"). At December 31, 2018 and 2017, the Company had approximately \$6,900,000 and \$9,000,000 in excess of FDIC insured limits, respectively. Our accounts receivable balances primarily represent amounts due from the residential, commercial and industrial customers of our regulated water utility operations, as well as receivables from our Service Corporation customers.

Accounts Receivable – Billed, Net

Accounts receivable are recorded at the invoiced amounts. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing accounts receivable and is determined based on historical write-off experience and the aging of account balances. We review the allowance for doubtful accounts quarterly. Account balances are written off against the allowance when it is probable the receivable will not be recovered.

Accounts Receivable – Unbilled, Net

We read our customer meters on a monthly basis and record revenues based on meter reading results. Information from the last meter reading date is used to estimate the value of unbilled revenues through the end of the accounting period. Estimates of water utility revenues for water delivered to customers but not yet billed are accrued at the end of each accounting period. Actual results could differ from those estimates.

Inventory

Inventory is stated at the lower of cost or net realizable value, cost being determined using the average cost method which approximates the first-in, first-out (FIFO) method.

Deferred Land Costs

Included in deferred land costs is the Company's original basis in its undeveloped landholdings and any land improvement costs, which are stated at the lower of cost or market. All costs associated with real estate and land projects are capitalized and allocated to the project to which the costs relate. Administrative labor and the related fringe benefit costs attributable to the acquisition, active development, and construction of land parcels are capitalized as deferred land costs. No labor and benefits were capitalized for the years ended December 31, 2018 and 2017.

Deferred Charges and Other Assets

Deferred charges include certain regulatory assets and other assets. Regulatory assets are amortized over the periods they are recovered through NHPUC-authorized water rates. The Company's utility subsidiaries have recorded certain regulatory assets in cases where the NHPUC has permitted, or is expected to permit, recovery of these costs over future periods. Currently, the regulatory assets are being amortized over periods ranging from 2 to 25 years.

Unamortized Debt Issuance Costs

Unamortized debt issuance costs are amortized over the term of the related bonds and notes. The Company's utility subsidiaries have recorded unamortized debt issuance costs in cases where the NHPUC has permitted or is expected to permit recovery of these costs over future periods. The debt issuance costs are being amortized over the lives of the associated debt.

Contributions in Aid of Construction

Under construction contracts with real estate developers and others, the Company's utility subsidiaries may receive non-refundable advances for the cost of installing new water mains. These advances are recorded as Contributions in Aid of Construction ("CIAC"). The utility subsidiaries also record to plant and CIAC the fair market value of developer installed mains and any excess of fair market value over the cost of community water systems purchased from developers. CIAC are amortized over the life of the related properties.

Revenues

Standard charges for water utility services to customers are recorded as revenue, based upon meter readings and contract service, as services are provided. The majority of the Company's water revenues are based on rates approved by the NHPUC. Estimates of unbilled service revenues are recorded in the period the services are provided. Provision is made in the consolidated financial statements for estimated uncollectible accounts.

Non-regulated water management services include contract operations and maintenance, and water testing and billing services to municipalities and small, privately owned community water systems. Contract revenues are billed and recognized on a monthly recurring basis in accordance with agreed-upon contract rates. Revenues from unplanned additional work are based upon time and materials incurred in connection with activities not specifically identified in the contract, or for which work levels exceed contracted amounts.

Revenues from real estate operations, other than undistributed earnings or losses from equity method joint ventures, are recorded upon completion of a sale of real property. The Company's real estate holdings outside of our regulated utilities are comprised primarily of undeveloped land.

Investment in Joint Venture

Southwood uses the equity method of accounting for its investment in a joint venture in which it does not have a controlling interest. Under this method, Southwood records its proportionate share of losses under “Other, net” in the accompanying Consolidated Statements of Income (Loss) with a corresponding decrease in the carrying value of the investment.

Income Taxes

Income taxes are recorded using the accrual method and the provision for federal and state income taxes is based on income reported in the consolidated financial statements, adjusted for items not recognized for income tax purposes. Provisions for deferred income taxes are recognized for accelerated depreciation and other temporary differences. A valuation allowance is provided to offset any net deferred tax assets if, based upon available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. Investment tax credits previously realized for income tax purposes are amortized for financial statement purposes over the life of the property, giving rise to the credit.

Change in Accounting Principles

Effective January 1, 2018, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*, which requires companies to report deferred tax assets and liabilities together as a single noncurrent item in their classified balance sheet. The Company has elected to apply the guidance prospectively as allowed by the standard, therefore there is no prior year effect to the financial statements as a result of this change.

Effective January 1, 2018, the Company adopted FASB ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalent. As a result, restricted cash and restricted cash equivalents are now included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This guidance is applied retrospectively as determined by the standard. The prior year statement of cash flows has been restated as a result of this change.

New Accounting Standards to be Adopted in the Future

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This standard also includes expanded disclosure requirements that result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity’s contracts with customers. This standard will be effective for the Company for the year ending December 31, 2019. The Company is currently in the process of evaluating the impact of adoption of this ASU on the financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, *Leases*. The ASU requires all leases with lease terms more than 12 months to be capitalized as a right of use asset and lease liability on the balance sheet at the date of lease commencement. Leases will be classified as either finance leases or operating leases. This distinction will be relevant for the pattern of expense recognition in the income statement. This ASU will be effective for the Company for the year ending December 31, 2020. The Company is currently in the process of evaluating the impact of adoption of this ASU on the financial statements.

Credit Losses

In June 2016, the FASB issued ASU 2016-13, *Measurement of Credit Losses on Financial Instruments*. The ASU requires a financial asset (including trade receivables) measured at amortized cost basis to be presented at the net amount expected to be collected. Thus, the income statement will reflect the measurement of credit losses for newly-recognized financial assets as well as the expected increases or decreases of expected credit losses that have taken place during the period. This ASU will be effective for the Company for the year ending December 31, 2021. The Company is currently in the process of evaluating the impact of adoption of this ASU on the financial statements.

Note 2 – Property, Plant and Equipment

The components of property, plant and equipment as of December 31, 2018 and 2017 were as follows:

(in thousands)	2018	2017	Useful Lives (in years)
Utility Property:			
Land and land rights	\$ 3,346	\$ 3,305	-
Source of supply	65,807	65,608	3 - 70
Pumping and purification	29,823	31,075	7 - 64
Transmission and distribution, including services, meters and hydrants	176,263	161,193	15 - 91
General and other equipment	16,742	16,541	7 - 75
Intangible plant	790	790	20
Construction work in progress	2,175	1,978	
Total utility property	294,946	280,490	
Total non-utility property	5	5	5 - 10
Total property, plant and equipment	294,951	280,495	
Less accumulated depreciation	(73,091)	(69,997)	
Property, plant and equipment, net	\$ 221,860	\$ 210,498	

The provision for depreciation is computed on the straight-line method over the estimated useful lives of the assets, which range from 3 to 91 years. The weighted average composite depreciation rate was 2.54% and 2.56% in 2018 and 2017, respectively.

Note 3 – Restricted Cash

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the consolidated balance sheets that sum to the total of the same such amounts shown in the statement of cash flows.

(in thousands)	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 1,575	\$ 994
Restricted cash - RSF	3,428	4,953
Restricted cash - Bond Project Funds	<u>3,337</u>	<u>3,288</u>
Total cash, cash equivalents and restricted cash shown in the consolidated statements of cash flows	<u>\$ 8,340</u>	<u>\$ 9,235</u>

Amounts included in restricted cash represent those required to be set aside as outlined in Note 1.

Note 4 – Accounts Receivable

Accounts receivable consisted of the following at December 31, 2018 and 2017:

(in thousands)	<u>2018</u>	<u>2017</u>
Accounts receivable - billed	\$ 3,461	\$ 3,457
Less allowance for doubtful accounts	<u>(44)</u>	<u>(37)</u>
Accounts receivable - billed, net	<u>\$ 3,417</u>	<u>\$ 3,420</u>
Accounts receivable - unbilled	\$ 2,927	\$ 2,265
Less allowance for doubtful accounts	<u>-</u>	<u>-</u>
Accounts receivable - unbilled, net	<u>\$ 2,927</u>	<u>\$ 2,265</u>

Note 5 – Deferred Charges and Other Assets

Deferred charges and other assets as of December 31, 2018 and 2017 consisted of the following:

(in thousands)	<u>2018</u>	<u>2017</u>	<u>Recovery Period (in years)</u>
Regulatory assets:			
Source development charges	\$ 873	\$ 952	5 - 25
Miscellaneous studies	865	980	2 - 25
Unrecovered pension and post-retirement benefits expense	<u>8,197</u>	<u>8,244</u>	(1)
Total regulatory assets	9,935	10,176	
Supplemental executive retirement plan asset	<u>762</u>	<u>735</u>	
Total deferred charges and other assets	<u>\$ 10,697</u>	<u>\$ 10,911</u>	

(1) We expect to recover these amounts consistent with the anticipated expense recognition of these assets.

Note 6 – Post-retirement Benefit Plans

Pension Plan and Other Post-retirement Benefits

The Company has a non-contributory, defined benefit pension plan (the “DB Plan”) that covers substantially all employees. The benefits are based on years of service and participant compensation levels. The Company’s funding policy is to contribute annual amounts that meet the requirements for funding under the U.S. Department of Labor’s Pension Protection Act. Contributions are intended to provide not only for benefits attributed to service to date, but also for those expected to be earned in the future.

Post-retirement medical benefits are provided for eligible retired employees through one of two plans (collectively referred to as our “OPEB Plans”). For employees who retire on or after the normal retirement age of 65, benefits are provided through a post-retirement plan (the “Post-65 Plan”). For eligible non-union employees who retire prior to their normal retirement age and who have met certain age and service requirements, benefits are provided through a post-employment medical plan (the “Post-employment Plan”). Future benefits under the Post-65 Plan increase annually based on the actual percentage of wage and salary increases earned from the plan inception date to the normal retirement date. The benefits under the Post-employment Plan allow for the continuity of medical benefits coverage at group rates from the employee’s retirement date until the employee becomes eligible for Medicare, which are fully funded by the retiree. The liability related to the Post-65 Plan will be funded from the general assets of our Company.

Upon retirement, if a qualifying employee elects to receive medical benefits under our Post-65 Plan, we pay up to a maximum monthly benefit of \$350 based on years of service.

The following table sets forth information regarding our DB Plan and our OPEB Plans as of December 31, 2018 and for the year then ended:

(in thousands)	DB Plan	OPEB Plans
Projected benefit obligations	\$ 27,369	\$ 3,735
Employer contribution	1,097	11
Benefits paid, excluding expenses	(648)	(58)
Fair value of plan assets	17,348	534
Accumulated benefit obligation	24,823	-
Funded status	(10,021)	(3,201)
Net periodic benefit cost	1,286	251
Amount of the funded status recognized in the Consolidated Balance Sheet consisted of:		
Current liability	-	-
Non-current liability	(10,021)	(3,201)
Total	<u>\$ (10,021)</u>	<u>\$ (3,201)</u>

The following table sets forth information regarding our DB Plan and our OPEB Plans as of December 31, 2017 and for the year then ended:

(in thousands)	DB Plan	OPEB Plans
Projected benefit obligations	\$ 27,558	\$ 3,660
Employer contribution	1,111	11
Benefits paid, excluding expenses	(643)	(52)
Fair value of plan assets	17,766	612
Accumulated benefit obligation	24,760	-
Funded status	(9,792)	(3,047)
Net periodic benefit cost	1,368	218
Amount of the funded status recognized in the Consolidated Balance Sheet consisted of:		
Current liability	-	-
Non-current liability	(9,792)	(3,047)
Total	<u>\$ (9,792)</u>	<u>\$ (3,047)</u>

Changes in plan assets and benefit obligations recognized in regulatory assets, for the year ended December 31, 2018, were as follows:

(in thousands)	<u>DB Plan</u>	<u>OPEB Plans</u>
Regulatory asset balance, beginning of period	\$ 7,593	\$ 651
Net actuarial loss incurred during the period	374	(77)
Prior service cost incurred during the period	-	16
Recognized net actuarial (gain)/loss	<u>(335)</u>	<u>(25)</u>
Regulatory asset balance, end of period	<u>\$ 7,632</u>	<u>\$ 565</u>

Changes in plan assets and benefit obligations recognized in regulatory assets, for the year ended December 31, 2017, were as follows:

(in thousands)	<u>DB Plan</u>	<u>OPEB Plans</u>
Regulatory asset balance, beginning of period	\$ 7,067	\$ 390
Net actuarial gain incurred during the period	871	259
Prior service cost incurred during the period	-	16
Recognized net actuarial (gain)/loss	<u>(345)</u>	<u>(14)</u>
Regulatory asset balance, end of period	<u>\$ 7,593</u>	<u>\$ 651</u>

Amounts recognized in regulatory assets for the DB and OPEB Plans that have not yet been recognized as components of net periodic benefit cost of the following as of December 31, 2018:

(in thousands)	<u>DB Plan</u>	<u>OPEB Plans</u>
Net actuarial loss	\$ 7,632	\$ 712
Prior service cost	<u>-</u>	<u>(147)</u>
Regulatory asset	<u>\$ 7,632</u>	<u>\$ 565</u>

Amounts recognized in regulatory assets for the DB and OPEB Plans that have not yet been recognized as components of net periodic benefit cost of the following as of December 31, 2017:

(in thousands)	<u>DB Plan</u>	<u>OPEB Plans</u>
Net actuarial loss	\$ 7,593	\$ 815
Prior service cost	<u>-</u>	<u>(164)</u>
Regulatory asset	<u>\$ 7,593</u>	<u>\$ 651</u>

The key assumptions used to value benefit obligations and calculate net periodic benefit cost for our DB and OPEB Plans include the following:

	<u>2018</u>	<u>2017</u>
Discount rate for net periodic benefit cost, beginning of year	3.50%	4.02%
Discount rate for benefit obligations, end of year ^(a)	4.15%	3.50%
Expected return on plan assets for the period (net of investment expenses)	7.00%	7.00%
Rate of compensation increase, beginning of year	3.00%	3.00%
Healthcare cost trend rate (applicable only to OPEB Plans)	7.00%	7.50%

^(a) An increase or decrease in the discount rate of 0.5% would result in a change in the funded status as of December 31, 2018, for the DB Plan and the OPEB Plans of approximately \$2.0 million and \$316 thousand, respectively.

The estimated net actuarial loss for our DB Plan that will be amortized in 2019 from the regulatory assets into net periodic benefit costs is \$372,000. The estimated net actuarial gain and prior service cost for our OPEB Plans that will be amortized in 2019 from the regulatory assets into net periodic benefit costs is \$5,300.

In establishing its investment policy, the Company has considered the fact that the DB Plan is a major retirement vehicle for its employees and the basic goal underlying the establishment of the policy is to provide that the assets of the DB Plan are invested in accordance with the asset allocation range targets to achieve our expected return on DB Plan assets. The Company's investment strategy applies to its OPEB Plans as well as the DB Plan. The expected long-term rate of return on DB Plan and OPEB Plan assets is based on the Plans' expected asset allocation, expected returns on various classes of Plan assets, as well as historical returns.

The assets of our Post-65 Plan are held in two separate Voluntary Employee Beneficiary Association ("VEBA") trusts. The VEBA plan assets are maintained in directed trust accounts at a commercial bank.

The investment strategy for the Company's DB Plan and OPEB Plans utilizes several different asset classes with varying risk/return characteristics. The following table indicates the asset allocation percentages of the fair value of the DB Plan and OPEB Plans' assets for each major type of plan asset as of December 31, 2018, as well as the targeted allocation range:

	<u>DB Plan</u>		<u>OPEB Plans</u>	
		<u>Asset Allocation Range</u>		<u>Asset Allocation Range</u>
Equities	59%	30% - 100%	65%	30% - 100%
Fixed income	41%	20% - 70%	32%	0% - 50%
Cash and cash equivalents	<u>0%</u>	0% - 15%	<u>3%</u>	0% - 15%
Total	<u>100%</u>		<u>100%</u>	

The following table indicates the asset allocation percentages of the fair value of the DB Plan and OPEB Plans' assets for each major type of plan asset as of December 31, 2017, as well as the targeted allocation range:

	DB Plan		OPEB Plans	
		Asset Allocation Range		Asset Allocation Range
Equities	63%	30% - 100%	69%	30% - 100%
Fixed income	37%	20% - 70%	29%	0% - 50%
Cash and cash equivalents	0%	0% - 15%	2%	0% - 15%
Total	<u>100%</u>		<u>100%</u>	

Management uses its best judgment in estimating the fair value of its financial instruments. However, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts that we could realize in a sales transaction for these instruments. The estimated fair value amounts have been measured as of year-end and have not been reevaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates.

Investments in common stock and mutual funds are stated at fair value by reference to quoted market prices. Money market funds are valued utilizing the net asset value per unit based on the fair value of the underlying assets as determined by the directed trustee.

The DB Plan also holds assets under an immediate participation guarantee group annuity contract with a life insurance company. The assets under the contract are invested in pooled separate accounts and in a general investment account. The pooled separate accounts are valued based on net asset value (NAV) per unit of participation in the fund. The NAV is used as a practical expedient to estimate fair values. This practical expedient is not used when it is determined to be probable that the fund will sell the investment for an amount different than that reported at NAV. These accounts have no unfunded commitments or significant redemption restrictions at year-end. The value of these units is determined by the trustee based on the current market values of the underlying assets of the pooled separate accounts. Therefore, the value of the pooled separate accounts is deemed to be at estimated fair value.

The general investment account is not actively traded, and significant other observable inputs are not available. The fair value of the general investment account is calculated by discounting the related cash flows based on current yields of similar instruments with comparable durations.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan's management believes the valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain investments could result in a different fair value measurement at the reporting date.

A fair value hierarchy which prioritizes the inputs to valuation methods is used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

The fair value of DB Plan and OPEB Plan assets by levels within the fair value hierarchy used as of December 31, 2018 was as follows:

(in thousands)	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
DB Plan:				
Guaranteed Interest Accounts	\$ 4,414	\$ -	\$ -	\$ 4,414
Total Assets in the Fair Value Hierarchy	4,414	-	-	4,414
Investments measured at net asset value ^(a)	12,934	-	-	-
DB Plan Investments, at Fair Value	17,348	-	-	4,414
OPEB Plans:				
Common stocks	252	252	-	-
Mutual funds	93	93	-	-
Fixed income funds	170	170	-	-
Money market funds	19	-	19	-
Total Assets in the Fair Value Hierarchy	534	515	19	-
Investments measured at net asset value ^(a)	-	-	-	-
OPEB Plans Investments, at Fair Value	534	515	19	-
Totals	\$ 17,882	\$ 515	\$ 19	\$ 4,414

(a) In accordance with Subtopic 820-10, certain investments that were measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statements of assets available for benefits of the Plans.

The fair value of DB Plan and OPEB Plan assets by levels within the fair value hierarchy used as of December 31, 2017 was as follows:

(in thousands)	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
DB Plan:				
Guaranteed Interest Accounts	\$ 3,215	\$ -	\$ -	\$ 3,215
Total Assets in the Fair Value Hierarchy	3,215	-	-	3,215
Investments measured at net asset value ^(a)	14,551	-	-	-
DB Plan Investments, at Fair Value	17,766	-	-	3,215
OPEB Plans:				
Common stocks	310	310	-	-
Mutual funds	111	111	-	-
Fixed income funds	180	180	-	-
Money market funds	11	-	11	-
Total Assets in the Fair Value Hierarchy	612	601	11	-
Investments measured at net asset value ^(a)	-	-	-	-
OPEB Plans Investments, at Fair Value	612	601	11	-
Totals	\$ 18,378	\$ 601	\$ 11	\$ 3,215

(a) In accordance with Subtopic 820-10, certain investments that were measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statements of assets available for benefits of the Plans.

Level 1: Based on quoted prices in active markets for identical assets.

Level 2: Based on significant observable inputs.

Level 3: Based on significant unobservable inputs.

The following table summarizes investments at fair value based on NAV per share as of December 31, 2018 and 2017, respectively:

(in thousands)	<u>Fair Value</u>
December 31, 2018	
Pooled Separate Accounts:	
Equities	\$ 10,257
Fixed Income	2,677
Total Pooled Separate Accounts	\$ 12,934
December 31, 2017	
Pooled Separate Accounts:	
Equities	\$ 11,117
Fixed Income	3,434
Total Pooled Separate Accounts	\$ 14,551

The following table presents a period-end reconciliation of DB Plan assets measured and recorded at fair value on a recurring basis, using significant unobservable inputs (Level 3):

(in thousands)	2018	2017
Balance, beginning of year	\$ 3,215	\$ 2,264
Plan transfers	1,548	1,314
Contributions	219	222
Benefits paid	(645)	(651)
Return on plan assets (net of investment expenses)	77	66
Balance, end of year	<u>\$ 4,414</u>	<u>\$ 3,215</u>

In order to satisfy the minimum funding requirements of the Employee Retirement Income Security Act of 1974, applicable to defined benefit pension plans, the Company anticipates it will contribute approximately \$1.1 million to the DB Plan in 2019.

The following maximum benefit payments, which reflect expected future service, as appropriate, are expected to be paid in the years indicated:

(in thousands)	DB Plan	OPEB Plans
2019	\$ 988	\$ 84
2020	994	87
2021	1,129	104
2022	1,257	121
2023	1,307	126
2024 - 2028	<u>8,191</u>	<u>820</u>
Total	<u>\$ 13,866</u>	<u>\$ 1,342</u>

Because the Company is subject to regulation in the state in which it operates, we are required to maintain our accounts in accordance with the regulatory authority's rules and regulations. In those instances, we follow the guidance of ASC 980 ("Regulated Operations"). Based on prior regulatory practice, we recorded underfunded DB Plan and OPEB Plan obligations as a regulatory asset, and we expect to recover those costs in rates charged to customers.

Defined Contribution Plan

In addition to the defined benefit plan, the Company provides and maintains a defined contribution plan covering substantially all employees. Under this plan, the Company matches 100% of the first 3% of each participating employee's salary contributed to the plan. The matching employer's contributions, recorded as operating expenses, were approximately \$269,000 and \$239,000 for the years ended December 31, 2018 and 2017, respectively.

Note 7 - Commitments and Contingencies

Operating Leases

The Company's corporate office space, as well as certain office equipment, is leased under operating lease agreements. Total rent expense was approximately \$367,400 and \$309,800 for the years ended December 31, 2018 and 2017, respectively.

The remaining non-cancelable lease commitments for the corporate office space and leased equipment as of December 31, 2018 were as follows:

(in thousands)	<u>Amount</u>
2019	\$ 356
2020	344
2021	345
2022	<u>203</u>
Total	<u>\$ 1,248</u>

Note 8 – Financial Measurement and Fair Value of Financial Instruments

Management uses its best judgment in estimating the fair value of its financial instruments. However, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts that we could realize in a sales transaction for these instruments. The estimated fair value amounts have been measured as of the period end and have not been reevaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates.

A fair value hierarchy is used, which prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of fair value hierarchy are as follows:

Level 1: Based on quoted prices in active markets for identical assets.

Level 2: Based on significant observable inputs.

Level 3: Based on significant unobservable inputs.

An asset or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For assets and liabilities measured at fair value on a recurring basis, the fair value measurement by levels within the fair value hierarchy used as of December 31, 2018 and 2017 were as follows:

		December 31, 2018			
(in thousands)		Total	Level 1	Level 2	Level 3
Liabilities:					
Interest rate swap		\$ <u>(263)</u>	\$ <u>-</u>	\$ <u>(263)</u>	\$ <u>-</u>

		December 31, 2017			
(in thousands)		Total	Level 1	Level 2	Level 3
Liabilities:					
Interest rate swap		\$ <u>(374)</u>	\$ <u>-</u>	\$ <u>(374)</u>	\$ <u>-</u>

The carrying value of certain financial instruments included in the accompanying Consolidated Balance Sheets, along with the related fair value, as of December 31, 2018 and 2017 was as follows:

		2018		2017	
(in thousands)		Carrying Value	Fair Value	Carrying Value	Fair Value
Liabilities:					
Long-term debt		\$ (210,588)	\$ (234,381)	\$ (207,709)	\$ (234,509)
Interest rate swap liability		\$ (263)	\$ (263)	\$ (374)	\$ (374)

The fair value of long-term debt has been determined by discounting the future cash flows using current market interest rates for similar financial instruments of the same duration. The fair value for long-term debt shown above does not purport to represent the amounts at which those debt obligations would be settled. The fair market value of the interest rate swap represents the estimated cost to terminate this agreement as of December 31, 2018 and 2017 based upon the then-current interest rates and the related credit risk.

The carrying values of our Cash and Cash Equivalents, Accounts Receivable and Accounts Payable approximate their fair values because of their short maturity dates. The carrying value of our CIAC approximates its fair value because it is expected that this is the amount that will be recovered in future rates.

Note 9 – Income Taxes

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the TCJA). The TCJA makes broad and complex changes to the U.S. tax code, including, but not limited to, (1) reducing the U.S. federal corporate tax rate from 35 percent to 21 percent; (2) elimination of the corporate alternative minimum tax (AMT) and changing how existing AMT credits can be realized; (3) changing rules related to usage and limitation of net operating loss carryforwards created in tax years beginning after December 31, 2017; (4) changing rules related to limitation of interest expense deductions; and (5) the taxation of CIAC as income for Regulated Water Utilities, due to the elimination of an exemption allowed prior to the TCJA. Certain of the TCJA's provisions require interpretation, which may be clarified through issuances of guidance by the U.S. Treasury Department, regulations, or future technical corrections.

FASB ASC 740 requires companies to recognize the effects of tax law changes in the period of enactment, which for the Company was for the year ended December 31, 2017, even though the effective date of most provisions of the TCJA is January 1, 2018.

At December 31, 2017, the Company's revaluation of federal deferred tax balances to reflect the 21% corporate income tax rate resulted in a one-time, non-cash expense of approximately \$2,500,000, included in the Company's 2017 provision for income taxes, offset by an increase in deferred income tax liabilities.

The components of the federal and state income tax provision (benefit) as of December 31, 2018 and 2017 were as follows:

(in thousands)	<u>2018</u>	<u>2017</u>
Federal	\$ 913	\$ 1,057
State	812	84
Amortization of investment tax credits	<u>(33)</u>	<u>(33)</u>
Total	<u>\$ 1,692</u>	<u>\$ 1,108</u>
Current	\$ 518	\$ -
Deferred	<u>1,174</u>	<u>1,108</u>
Total	<u>\$ 1,692</u>	<u>\$ 1,108</u>

The following is a reconciliation between the statutory federal income tax rate and the effective income tax rate for 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Statutory federal rate	21.0%	34.0%
State tax rate, net of federal benefits	6.2%	6.2%
Permanent differences	-75.7%	-15.8%
Tax rate change	0.0%	-45.8%
Amortization of investment tax credits	<u>0.9%</u>	<u>0.6%</u>
Effective tax rate	<u><u>-47.6%</u></u>	<u><u>-20.8%</u></u>

The temporary items that give rise to the net deferred tax liability as of December 31, 2018 and 2017 were as follows:

(in thousands)	<u>2018</u>	<u>2017</u>
Liabilities:		
Property-related, net	\$ 20,682	\$ 19,967
Other	<u>424</u>	<u>373</u>
Total liabilities	<u>21,106</u>	<u>20,340</u>
Assets:		
Pension accrued liability	1,272	1,186
Net operating loss carryforward	4,556	5,042
Alternative minimum tax credit	476	476
NH Business Enterprise Tax credits	997	853
Other	<u>692</u>	<u>789</u>
	7,993	8,346
Less valuation allowance	<u>(997)</u>	<u>(853)</u>
Total assets	<u>6,996</u>	<u>7,493</u>
Net non-current deferred income tax liability	<u><u>\$ 14,110</u></u>	<u><u>\$ 12,847</u></u>

The Company has accumulated federal net operating losses. The federal tax benefit of the cumulative net operating losses is approximately \$3.4 million, begin to expire in 2032, and is included in deferred income taxes in the Consolidated Balance Sheet as of December 31, 2018. The net operating losses are 100 percent available to be applied to taxable income in future years and are not subject to the TCJA as they were generated prior to the 2018 tax year. The enactment of the TCJA now limits the net operating loss shelter to 80 percent of taxable income, for post-2017 tax year losses. The TCJA also provides for net operating losses to be carried forward indefinitely instead of limited to 20 years, as is the case for pre-2018 losses; however, carrybacks of these losses are no longer permitted.

The Company has accumulated New Hampshire net operating losses. The New Hampshire tax benefit of the cumulative net operating loss is approximately \$1.1 million which begins to expire in 2022, and is included in deferred income taxes in the Consolidated Balance Sheet as of December 31, 2018.

As of December 31, 2018 and 2017, it is estimated that approximately \$476,000 and \$476,000, respectively, of cumulative federal alternative minimum tax credits may be carried forward indefinitely as a credit against our regular tax liability.

As of December 31, 2018 and 2017, the Company had New Hampshire Business Enterprise Tax ("NHBET") credits of approximately \$997,000 and \$853,000, respectively. NHBET credits begin to expire in 2019. It is anticipated that these NHBET credits will not be fully utilized before they expire; therefore, a valuation allowance has been recorded related to these credits. The valuation allowance increased by \$144,000 and \$126,000 in the years ended December 31, 2018 and 2017, respectively.

Investment tax credits resulting from utility plant additions are deferred and amortized. The unamortized investment tax credits are being amortized through the year 2033.

The Company had a regulatory liability related to income taxes of approximately \$9,943,000 and \$9,955,000 as of December 31, 2018 and 2017, respectively. This represents the estimated future reduction in revenues associated with deferred taxes which were collected at rates higher than the currently enacted rates and the amortization of deferred investment tax credits.

A review of the portfolio of uncertain tax positions was performed. In this regard, an uncertain tax position represents the expected treatment of a tax position taken in a filed tax return, or planned to be taken in a future tax return, that has not been reflected in measuring income tax expense for financial reporting purposes. As a result of this review, it was determined that the Company had no material uncertain tax positions, and tax planning strategies will be used, if required and when possible, to avoid the expiration of any future net operating loss and/or tax credits.

The Company's practice is to recognize interest and/or penalties related to income tax matters in "Other, Net" in the Consolidated Statements of Income. We incurred no interest in 2018 and 2017. We incurred no penalties during the years ended December 31, 2018 and 2017, respectively.

Note 10 – Long-Term Debt

Long-term debt as of December 31, 2018 and 2017 consisted of the following:

(in thousands)	2018	
	Principal	Unamortized Debt Issuance Costs
Unsecured note payable to City of Nashua, 5.75%, due 12/25/2041	\$ 106,830	\$ -
Unsecured senior note payable due to an insurance company 7.40%, due March 1, 2021	3,200	18
Unsecured Business Finance Authority:		
Revenue Bonds (Series 2014A), interest rates from 3.00% to 4.125%, due January 1, 2045	38,905	1,803
Revenue Bonds (Series 2014B), 4.50%, due January 1, 2045	5,030	114
Revenue Bonds (Series 2015A), interest rates from 4.00% to 5.00%, due January 1, 2046	19,490	1,450
Revenue Bonds (Series 2015B), 5.00%, due January 1, 2046	1,840	230
Revenue Bonds (Series 2018A), interest rates from 4.375% to 5.00%, due April 1, 2048	4,460	325
Revenue Bonds (Series 2018B), 4.33%, due April 1, 2028	1,075	-
Unsecured notes payable to bank, floating-rate, due March 1, 2030	2,928	14
Unsecured notes payable to bank, 3.62%, due June 20, 2023	1,367	7
Unsecured notes payable to bank, 4.20%, due December 20, 2041	1,192	6
Unsecured notes payable to bank, 4.83%, due December 20, 2041	909	5
Unsecured notes payable to bank, 4.25%, due June 20, 2033	744	7
Unsecured notes payable to bank, 4.90%, due March 6, 2040	573	35
Unsecured notes payable to bank, 5.33%, due June 20, 2043	346	19
Unsecured New Hampshire State Revolving Fund (“SRF”) notes (1)	21,699	182
Unamortized debt issuance costs for defeased obligations, allowed by regulation	-	129
Total	210,588	\$ 4,344
Less current portion	(6,019)	
Less unamortized debt issuance costs	(4,344)	
Total long-term debt, less current portion and unamortized debt issuance costs	\$ 200,225	

(1) SRF notes are due through 2049 at interest rates ranging from 1% to 3.8%. These notes are payable in 120 to 240 consecutive monthly installments of principal and interest. The 1% rate applies to construction projects still in process until the earlier of (i) the date of substantial completion of the improvements, or (ii) various dates specified in the note (such earlier date being the interest rate change date). Commencing on the interest rate change date, the interest rate changes to the lower of (i) the rate as stated in the note or (ii) 80% of the established 11 General Obligations Bond Index published during the specified time period before the interest rate change date.

(in thousands)	2017	
	Principal	Unamortized Debt Issuance Costs
Unsecured note payable to City of Nashua, 5.75%, due 12/25/2041	\$ 108,960	\$ -
Unsecured senior note payable due to an insurance company 7.40%, due March 1, 2021	3,600	27
Unsecured Business Finance Authority:		
Revenue Bonds (Series 2014A), interest rates from 3.00% to 4.125%, due January 1, 2045	39,935	1,949
Revenue Bonds (Series 2014B), 4.50%, due January 1, 2045	5,125	118
Revenue Bonds (Series 2015A), interest rates from 4.00% to 5.00%, due January 1, 2046	20,035	1,527
Revenue Bonds (Series 2015B), 5.00%, due January 1, 2046	1,940	251
Unsecured notes payable to bank, floating-rate, due March 1, 2030	3,134	16
Unsecured notes payable to bank, 3.62%, due June 20, 2023	1,438	9
Unsecured notes payable to bank, 4.20%, due December 20, 2041	1,221	7
Unsecured notes payable to bank, 4.83%, due December 20, 2041	930	5
Unsecured notes payable to bank, 4.25%, due June 20, 2033	780	7
Unsecured notes payable to bank, 4.90%, due March 6, 2040	588	36
Unsecured New Hampshire State Revolving Fund ("SRF") notes (1)	20,023	182
Unamortized debt issuance costs for defeased obligations, allowed by regulation	-	95
Total	207,709	\$ 4,229
Less current portion	(5,575)	
Less unamortized debt issuance costs	(4,229)	
Total long-term debt, less current portion and unamortized debt issuance costs	\$ 197,905	

(1) SRF notes are due through 2048 at interest rates ranging from 1% to 3.8%. These notes are payable in 120 to 240 consecutive monthly installments of principal and interest. The 1% rate applies to construction projects still in process until the earlier of (i) the date of substantial completion of the improvements, or (ii) various dates specified in the note (such earlier date being the interest rate change date). Commencing on the interest rate change date, the interest rate changes to the lower of (i) the rate as stated in the note or (ii) 80% of the established 11 General Obligations Bond Index published during the specified time period before the interest rate change date.

The aggregate principal payment requirements subsequent to December 31, 2018 are as follows:

(in thousands)	<u>Amount</u>
2019	\$ 6,019
2020	6,372
2021	8,660
2022	6,561
2023	7,859
2024 and thereafter	<u>175,117</u>
Total	<u>\$ 210,588</u>

Several of Pennichuck Water's loan agreements contain a covenant that prevents Pennichuck Water from declaring dividends if Pennichuck Water does not maintain a minimum net worth of \$4.5 million. As of December 31, 2018 and 2017, Pennichuck Water's net worth was \$112.4 million and \$118.0 million, respectively.

The 2014A, 2014B, 2015A, 2015B, 2018A and 2018B bonds were issued under a new bond indenture and loan and trust agreement, established with the issuance of the 2014 Series Bonds, which contains certain covenant obligations upon Pennichuck Water, which are as follows:

Debt to Capital Covenant - Pennichuck Water cannot create, issue, incur, assume or guarantee any short-term debt if (1) the sum of the short-term debt plus its funded debt ("Debt") shall exceed 85% of the sum of its short-term debt, funded debt and capital stock plus surplus accounts ("Capital"), unless the short-term debt issued in excess of the 85% is subordinated to the Series 2014 bonds. Thereby, the ratio of Debt to Capital must be equal to or less than 1.0. As of December 31, 2018 and 2017, Pennichuck Water Works has a Debt to Capital Coverage ratio of 0.5 and 0.5, respectively.

All Bonds Test - Additionally, Pennichuck Water cannot create, issue, incur, assume or guarantee any new funded debt, if the total outstanding funded debt ("Total Funded Debt") will exceed the sum of MARA (as defined in Note 1 of these consolidated financial statements) and 85% of its Net Capital Properties ("MARA and Capital Properties"), and unless net revenues or EBITDA (earnings before interest, taxes, depreciation and amortization) shall equal or exceed for at least 12 consecutive months out of the 15 months preceding the issuance of the new funded debt by 1.1 times the maximum amount for which Pennichuck Water will be obligated to pay in any future year ("Max Amount Due"), as a result of the new funded debt being incurred. Thereby, the ratio of Total Funded Debt to MARA and Capital Properties must be equal to or less than 1.0; as of December 31, 2018 and 2017, this coverage ratio was 0.4 and 0.4, respectively. Also, the ratio of EBITDA to the Max Amount Due must be equal to or greater than 1.1; as of December 31, 2018 and 2017, this ratio was 1.6 and 1.5, respectively.

Rate Covenant Test - If during any fiscal year, the EBITDA of Pennichuck Water shall not equal at least 1.1 times all amounts paid or required to be paid during that year (“Amounts Paid”), then the Company shall undertake reasonable efforts to initiate a rate-making proceeding with the NH Public Utilities Commission, to rectify this coverage requirement in the succeeding fiscal years. Thereby, the ratio of EBITDA to Amounts Paid must be equal to or greater than 1.1; as of December 31, 2018 and 2017, the Rate Covenant coverage ratio was 1.48 and 1.41, respectively.

Pennichuck East’s loan agreement for its unsecured notes payable to a bank of \$8.1 million and \$8.1 million at December 31, 2018 and 2017, respectively, contains a minimum debt service coverage ratio requirement of 1.10. At December 31, 2018 and 2017, this ratio was 0.89 and 0.92, respectively. This covenant has not been met, and the Bank has waived such noncompliance. Also, Pennichuck East is required to maintain a maximum ratio of total debt to total capitalization of 65%; at December 31, 2018 and 2017, this ratio was 65% and 59%, respectively.

As of December 31, 2018 and 2017, the Company had a \$2.9 million and \$3.1 million, respectively, interest rate swap which qualifies as a derivative. This financial derivative is designated as a cash flow hedge. This financial instrument is used to mitigate interest rate risk associated with our outstanding \$2.9 million loan which has a floating interest rate based on the three-month London Interbank Offered Rate (“LIBOR”) plus 1.75% as of December 31, 2018. The combined effect of the LIBOR-based borrowing formula and the swap produces an “all-in fixed borrowing cost” equal to 5.95%. The fair value of the financial derivative, as of December 31, 2018 and 2017, included in our Consolidated Balance Sheets under “Other Liabilities and Deferred Credits” as “Derivative instrument” was \$263,000 and \$374,000, respectively. Changes in the fair value of this derivative were deferred in accumulated other comprehensive income.

Swap settlements are recorded in the statement of income (loss) with the hedged item as interest expense. During the years ended December 31, 2018 and 2017, \$59,000 and \$76,000, respectively, was reclassified pre-tax from accumulated other comprehensive income to interest expense as a result of swap settlements. The Company expects to reclassify approximately \$66,000, pre-tax, from accumulated other comprehensive income to interest expense as a result of swap settlements, over the next twelve months.

Note 11 – Lines of Credit

In April of 2018, the Company’s existing 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.

Short-term borrowing activity under Pennichuck Corp.'s Working Capital Line of Credit for the years ended December 31, 2018 and 2017 was:

(in thousands)	<u>2018</u>	<u>2017</u>
Established line as of December 31,	\$ 4,000	\$ 6,000
Maximum amount outstanding during period	5,981	5,574
Average amount outstanding during period	1,701	228
Amount outstanding as of December 31,	361	5,574
Weighted average interest rate during period	3.45%	3.01%
Interest rate as of December 31,	4.27%	3.10%

Short-term borrowing activity under Pennichuck Water's Fixed Asset Line of Credit for the year ended December 31, 2018 was:

(in thousands)	<u>2018</u>
Established line as of December 31,	\$ 10,000
Maximum amount outstanding during period	5,574
Average amount outstanding during period	1,821
Amount outstanding as of December 31,	5,574
Weighted average interest rate during period	3.05%
Interest rate as of December 31,	4.27%

Short-term borrowing activity under Pennichuck East's Fixed Asset Line of Credit for the year ended December 31, 2018 was:

(in thousands)	<u>2018</u>
Established line as of December 31,	\$ 3,000
Maximum amount outstanding during period	691
Average amount outstanding during period	113
Amount outstanding as of December 31,	691
Weighted average interest rate during period	3.11%
Interest rate as of December 31,	4.71%

The Company's revolving credit loan facilities with TD Bank contain certain covenant obligations upon Pennichuck Water, which are as follows:

Debt to Capital Covenant - Pennichuck Water cannot create, issue, incur, assume or guarantee any short-term debt if (1) the sum of the short-term debt plus its funded debt ("Debt") shall exceed 85% of the sum of its short-term debt, funded debt and capital stock plus surplus accounts ("Capital"), unless the short-term debt issued in excess of the 85% is subordinated to the loan facility. Thereby, the ratio of Debt to Capital must be equal to or less than 1.0. As of December 31, 2018, Pennichuck Water Works has a Debt to Capital Coverage ratio of 0.5.

All Bonds Test - Additionally, Pennichuck Water cannot create, issue, incur, assume or guarantee any new funded debt, if the total outstanding funded debt (“Total Funded Debt”) will exceed the sum of MARA (as defined in Note 1 of these consolidated financial statements) and 85% of its Net Capital Properties (“MARA and Capital Properties”), and unless net revenues or EBITDA (earnings before interest, taxes, depreciation and amortization) shall equal or exceed for at least 12 consecutive months out of the 15 months preceding the issuance of the new funded debt by 1.1 times the maximum amount for which Pennichuck Water will be obligated to pay in any future year (“Max Amount Due”), as a result of the new funded debt being incurred. Thereby, the ratio of Total Funded Debt to MARA and Capital Properties must be equal to or less than 1.0; as of December 31, 2018, this coverage ratio was 0.4. Also, the ratio of EBITDA to the Max Amount Due must be equal to or greater than 1.1; as of December 31, 2018 this ratio was 1.6.

Rate Covenant Test - If during any fiscal year, the EBITDA of Pennichuck Water shall not equal at least 1.1 times all amounts paid or required to be paid during that year (“Amounts Paid”), then the Company shall undertake reasonable efforts to initiate a rate-making proceeding with the NH Public Utilities Commission, to rectify this coverage requirement in the succeeding fiscal years. Thereby, the ratio of EBITDA to Amounts Paid must be equal to or greater than 1.1; as of December 31, 2018, the Rate Covenant coverage ratio was 1.48.

Note 12 – Accumulated Other Comprehensive Income

The following table presents changes in accumulated other comprehensive income by component for the years ended December 31, 2018 and 2017:

(in thousands)	Interest Rate Contract	
	2018	2017
Beginning balance	\$ 305	\$ 258
Other comprehensive income (loss) before reclassifications	32	1
Amounts reclassified from accumulated other comprehensive income	35	46
Net current period other comprehensive income	67	47
Ending balance	\$ 372	\$ 305

The following table presents reclassifications out of accumulated other comprehensive income for the years ended December 31, 2018 and 2017:

<u>Details about Accumulated Other Comprehensive Income Components</u> (in thousands)	<u>Amounts Reclassified from Accumulated Other Comprehensive Income</u>		<u>Affected Line Item in the Statement Where Net Income is Presented</u>
	<u>2018</u>	<u>2017</u>	
Gain (loss) on cash flow hedges			
Interest rate contracts	\$ 59	\$ 77	Interest expense
	<u>(24)</u>	<u>(31)</u>	Tax expense
Amounts reclassified from accumulated other comprehensive income	\$ <u>35</u>	\$ <u>46</u>	Net of tax

Note 13 – Transaction with the City of Nashua

On January 25, 2012, in full settlement of an ongoing Eminent Domain lawsuit filed by the City of Nashua (“City”) and with the approval of the New Hampshire Public Utilities Commission (“NHPUC”), the City acquired all of the outstanding shares of Pennichuck Corporation (“Pennichuck”) and, thereby, indirect acquisition of its regulated subsidiaries. The total amount of the acquisition was \$150.6 million (“Acquisition Price”) of which \$138.4 million was for the purchase of the outstanding shares, \$5.0 million for the establishment of a Rate Stabilization Fund, \$2.6 million for legal and due diligence costs, \$2.3 million for severance costs, \$1.3 million for underwriting fees, and \$1.0 million for bond discount and issue costs. The entire purchase of \$150.6 million was funded by General Obligation Bonds (“Bonds”) issued by the City of Nashua. Pennichuck is not a party to the Bonds and has not guaranteed nor is obligated in any manner for the repayment of the Bonds. Pennichuck remains an independent corporation with an independent Board of Directors, with the City of Nashua as its sole shareholder.

Pennichuck Water Works, Inc. (“PWW”), Pennichuck East Utility, Inc. (“PEU”), Pittsfield Aqueduct Company, Inc. (“PAC”), Pennichuck Water Service Corporation, and The Southwood Corporation will continue as subsidiaries of Pennichuck Corporation and PWW, PEU and PAC will continue as regulated companies under the jurisdiction of the New Hampshire Public Utilities Commission. The terms of the merger and the requisite accounting and rate-setting mechanisms were agreed to in the NHPUC Order 25,292 (“PUC Order”) dated November 23, 2011.

Transactions with Related Party – City of Nashua

Pennichuck issued a promissory note to the City of Nashua in the amount of approximately \$120 million to be repaid over a thirty (30) year period with monthly payments of approximately \$707,000, including interest at 5.75%. Pennichuck recorded an additional amount of approximately \$30.6 million as contributed capital. The remaining outstanding balance of the note payable to the City at December 31, 2018 and 2017 was approximately \$107 million and \$109 million, respectively, as disclosed in Note 10 to these consolidated financial statements. During 2018 and 2017, dividends of approximately \$280,000 and \$279,000, respectively, were declared and paid to the City. The dividends paid to the City during 2018 comprised approximately \$280,000 of regular quarterly dividends declared and paid; and no special dividend was declared or paid in 2018. The dividends paid to the City during 2017 comprised approximately \$279,000 of regular quarterly dividends declared and paid; and no special dividend was declared or paid in 2017.

Additional ongoing transactions occur in the normal course of business, between the Company and the City, related to municipal water usage, fire protection and sewer billing support services, and property taxes related to real property owned by the Company within the City of Nashua. For the years ended December 31, 2018 and 2017, respectively, approximately \$3.4 million and \$3.2 million were paid to the Company by the City for municipal water consumption, fire protection charges, and sewer billing support services. Conversely, the Company paid property taxes to the City of Nashua of approximately \$2.6 million for the year ended December 31, 2018, and approximately \$2.9 million for the year ended December 31, 2017.

Rate Stabilization Fund – Restricted Cash

As a part of the acquisition, Pennichuck agreed to contribute \$5,000,000 of the proceeds from the settlement transaction to PWW, which was used to establish a Rate Stabilization Fund (“RSF”), allowing for the maintenance of stable water utility rates and providing a mechanism to ensure the Company’s continued ability to meet its obligations under the promissory note to the City, in the event of adverse revenue developments. Restricted cash consists of amounts set aside in the RSF account and is adjusted monthly as required in the PUC Order, as discussed in Note 1 of these financial statements.

Municipal Acquisition Regulatory Asset (“MARA”)

Pursuant to the PUC Order, Pennichuck established a new Regulatory asset (MARA) which represents the amount that the Acquisition Price exceeded the net book assets of Pennichuck’s regulated subsidiaries (PWW, PEU, and PAC) at December 31, 2011. The initial amount of the MARA was approximately \$89 million for the regulated companies, offset by a non-regulated amount of approximately \$4.8 million. The MARA is to be amortized over a thirty (30) year period in the same manner as the repayment of debt service for the City’s acquisition bonds. The balance in the MARA at December 31, 2018 was approximately \$75.4 million, reduced by the non-regulated credit of approximately \$4.1 million.

Aggregate amortization expense for the years ended December 31, 2018 and 2017 totaled approximately \$1,958,000 and \$1,917,000, respectively.

The following table represents the total estimated amortization of MARA:

(in thousands)	Estimated Amortization Expense
2019	\$ 2,006
2020	2,061
2021	2,119
2022	2,183
2023	2,253
2024 and thereafter	<u>60,646</u>
Total	<u>\$ 71,268</u>

Note 14 – Segment Reporting

The Company is comprised of Pennichuck Corporation and its five wholly-owned subsidiaries, as described in Note 1 to these consolidated financial statements. For the years ended December 31, 2018 and 2017, and as of those dates, the following financial results were generated by the segments of the Company:

(in thousands)	2018	2017
<u>Operating Revenues:</u>		
Pennichuck Water Works, Inc.	\$ 32,391	\$ 29,584
Pennichuck East Utility, Inc.	8,724	7,198
Pittsfield Aqueduct Company, Inc.	791	792
Subtotal Regulated Segment	<u>41,906</u>	<u>37,574</u>
Water Management Services	3,347	3,308
Other	12	11
Total Operating Revenues	<u>\$ 45,265</u>	<u>\$ 40,893</u>
<u>Depreciation and Amortization Expense:</u>		
Pennichuck Water Works, Inc.	\$ 6,978	\$ 6,685
Pennichuck East Utility, Inc.	1,134	1,072
Pittsfield Aqueduct Company, Inc.	115	116
Subtotal Regulated Segment	<u>8,227</u>	<u>7,873</u>
Water Management Services	-	-
Other	(114)	(111)
Total Depreciation and Amortization Expense	<u>\$ 8,113</u>	<u>\$ 7,762</u>

(continued)

(continued)

(in thousands)	2018	2017
<u>Operating Income:</u>		
Pennichuck Water Works, Inc.	\$ 6,247	\$ 5,348
Pennichuck East Utility, Inc.	780	113
Pittsfield Aqueduct Company, Inc.	45	55
Subtotal Regulated Segment	7,072	5,516
Water Management Services	31	(93)
Other	-	53
Total Operating Income	\$ 7,103	\$ 5,476
<u>Interest Expense:</u>		
Pennichuck Water Works, Inc.	\$ 3,455	\$ 3,512
Pennichuck East Utility, Inc.	753	695
Pittsfield Aqueduct Company, Inc.	48	61
Subtotal Regulated Segment	4,256	4,268
Water Management Services	7	3
Other	6,647	6,562
Total Interest Expense	\$ 10,910	\$ 10,833
<u>Income Taxes Provision (Benefit):</u>		
Pennichuck Water Works, Inc.	\$ 2,351	\$ 1,366
Pennichuck East Utility, Inc.	771	66
Pittsfield Aqueduct Company, Inc.	111	17
Subtotal Regulated Segment	3,233	1,449
Water Management Services	7	(3)
Other	(1,548)	(338)
Total Income Taxes Provision (Benefit)	\$ 1,692	\$ 1,108
<u>Net Income (Loss):</u>		
Pennichuck Water Works, Inc.	\$ 459	\$ 490
Pennichuck East Utility, Inc.	(540)	(508)
Pittsfield Aqueduct Company, Inc.	(114)	24
Subtotal Regulated Segment	(195)	6
Water Management Services	16	(100)
Other	(5,103)	(6,347)
Total Net Income (Loss)	\$ (5,282)	\$ (6,441)

(continued)

(continued)

(in thousands)	2018	2017
<u>Total Net Assets:</u>		
Pennichuck Water Works, Inc.	\$ 279,467	\$ 267,689
Pennichuck East Utility, Inc.	55,942	51,915
Pittsfield Aqueduct Company, Inc.	3,332	3,499
Subtotal Regulated Segment	338,741	323,103
Water Management Services	(13)	(28)
Other	(15,594)	(8,284)
Total Net Assets	\$ 323,134	\$ 314,791
<u>Total Liabilities:</u>		
Pennichuck Water Works, Inc.	\$ 167,107	\$ 149,688
Pennichuck East Utility, Inc.	45,693	40,293
Pittsfield Aqueduct Company, Inc.	1,534	1,458
Subtotal Regulated Segment	214,334	191,439
Water Management Services	35	37
Other	100,355	109,410
Total Liabilities	\$ 314,724	\$ 300,886
<u>Total Long-Term Debt (including current portion):</u>		
Pennichuck Water Works, Inc.	\$ 80,838	\$ 78,096
Pennichuck East Utility, Inc.	18,435	16,273
Pittsfield Aqueduct Company, Inc.	146	151
Subtotal Regulated Segment	99,419	94,520
Water Management Services	-	-
Other	106,825	108,960
Total Long-Term Debt	\$ 206,244	\$ 203,480

Note 15 – Rate Cases

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 (OCA) agreed to a temporary rate increase at “current rates,” and as such, there was no impact on ratepayers for any temporary rate increases.

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.

On November 7, 2017, the PUC issued Order No. 26,070 approving a permanent rate increase of 3.12% and a 7.69% step increase for its customers. The permanent rate increase was effective on a bills-rendered basis on and after December 7, 2016. The step increase is effective the date of the order, November 7, 2017.

In addition to the rate increases granted in the order the NHPUC approved the following modifications to PWW’s rate structure:

- the establishment of a five-year average of revenues versus the previous test-year revenues methodology for allowed revenue calculations, and
- the creation of the following additional revenue requirements:
 - Operating Expense Revenue Requirement (OERR), and
 - Debt Service Revenue Requirement (DSRR)
- the establishment of dedicated Rate Stabilization Funds (RSFs) in support of the new revenue requirement 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.

Pennichuck East Utility, Inc.

On October 18, 2017, Pennichuck East Utility, Inc. (“PEU”) filed a request with the 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 establishment of a five-year average of revenues versus the previous test-year revenues methodology for allowed revenue calculations, and
- the creation of the following additional revenue requirements as similarly adopted for PWW in 2017:
 - Operating Expense Revenue Requirement (OERR), and
 - Debt Service Revenue Requirement (DSRR)
- the establishment of dedicated Rate Stabilization Funds (RSFs) in support of the revenue requirement 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 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 2018, on a going forward basis, as a subset of PWW's next allowed permanent rate increase.

Note 16 – Subsequent Events

The Company has evaluated the events and transactions that have occurred through March 20, 2019, the date that these consolidated financial statements were available for issuance, for which no reportable events were discovered.