

PENNICHUCK WATER SPECIAL COMMITTEE

JULY 24, 2018

A meeting of the Pennichuck Water Special Committee was held Tuesday, July 24, 2018, at 7:00 p.m. in the Aldermanic Chamber.

Alderman-at-Large Lori Wilshire, Chair, presided.

Members of Committee present: Alderman David C. Tencza, Vice Chair
Alderman-at-Large Brian S. McCarthy
Alderman Patricia Klee

Members not in Attendance: Alderman Richard A. Dowd

Also in Attendance: Larry Goodhue, CEO, Pennichuck
Don Ware, COO, Pennichuck
Thomas J. Leonard, Chairman, Pennichuck Board of Directors

PUBLIC COMMENT - None

COMMUNICATIONS

From: Larry D. Goodhue, CEO, Pennichuck Corporation
Re: Pennichuck Corporation Quarterly Report for Quarter Ended March 31, 2018

There being no objection, Chairman Wilshire accepted the communication and placed it on file.

From: Larry D. Goodhue, CEO, Pennichuck Corporation
Re: Request for Approval of Loans (Resolution R-18-058)

- Referred to Cmte – 7/10/2018

There being no objection, Chairman Wilshire accepted the communication and placed it on file.

UNFINISHED BUSINESS – None

NEW BUSINESS – RESOLUTIONS

R-18-058

Endorsers: Alderman-at-Large Lori Wilshire
Alderman Richard A. Dowd
Alderman Patricia Klee
Alderwoman Mary Ann Melizzi-Golja
Alderman-at-Large Michael B. O'Brien, Sr.

AUTHORIZING PENNICHUCK CORPORATION, PENNICHUCK WATER WORKS, INC., AND PENNICHUCK EAST UTILITY, INC., TO BORROW FUNDS FROM THE STATE OF NEW HAMPSHIRE DRINKING WATER REVOLVING LOAN FUND AND THE STATE OF NEW HAMPSHIRE DRINKING WATER AND GROUNDWATER TRUST FUND

MOTION BY ALDERMAN TENCZA TO RECOMMEND FINAL PASSAGE

ON THE QUESTION

Larry Goodhue, CEO, Pennichuck

Which would you like me to address first as far as the communications the loan or the quarterly report?

Chairman Wilshire

How about the loan?

Mr. Goodhue

Alright. So before you is a request for shareholder approval in support of two financings, one is for our Pennichuck East Utility subsidiary in the amount of \$4,240,000.00 through the State Drinking Water Trust Fund, actually the SRF fund, I apologize for that, the State Drinking Water revolving loan program. This loan is for our community water system in Barnstead, New Hampshire, being our Locke Lake water system. This is an overall approval based on money of which all of it may not be expended. That system up there, we have nearly a 1,000 customers on the water system up there, we are currently under a corrective action plan, relative to overall capacity of water in that system.

So in response to the corrective action plan that we have with the Department of Environmental Services, we are exploring and have been exploring other sources of supplemental water for that system. Our discovery has taken almost two years in the process of looking at other sites geographically close to the system to site another large water withdrawal well, which would require an extensive permitting process. We have been unable to find any sources that were nearby that actually geologically had the water that we needed and/or land owners that were willing to sell land in order to place a site on that that were a little bit further from the system.

So we are looking at further exploration relative to those sources including perhaps a surface water withdrawal at the lake itself, relative to that. That process is still undergoing study and analysis by our water shed engineer as well as a team at the company and consultants in response to that corrective action plan. This money is related to what the eventual solution is going to be in response to that including some water mains and treatment that are going to have to be put in place relative to that eventual solution.

The money was approved and offered to us by the DES so we wanted to take advantage of procuring that and getting that in place, such that when the solution comes to bear and we know exactly what it is, we know we have the funding source in place that is a low cost source of funds at reasonable closing costs and that we can act on the plan and actually get this put in place. It is probably going to take us close to the next 18 months to 2 years to get to the point where that solution actually comes to bear.

Chairman Wilshire

Is that the date that the corrective action needs to be completed?

Mr. Goodhue

We just have to make sure that we continue to act on the corrective action plan. We are working on an interactive basis with the DES. They are fully engaged with us on that process and so we have to continue to update as we progress along in this process, so we are working hand in glove with them on that.

Chairman Wilshire

Okay, questions from the committee?

Mr. Goodhue

The second loan, or did you need to say something?

Thomas J. Leonard, Chairman, Pennichuck Board of Directors

I know this is being viewed by the public and I don't mean to interrupt you Larry but just for those in the public that might not know, this is a system that is up north and was one of the systems that the private company Pennichuck acquired as part of its private history. So this is one that the City of Nashua kind of for lack of a better word inherited and our new model causes us to have to make some adjustments and of course that is what we are doing. But it is not going to be cost and expenses that the City of Nashua bear, it is just part of the whole regulated utility process. We happen to have a number of systems outside of the City of Nashua. So this is not something that each of the citizens of the City of Nashua is paying for.

Mr. Goodhue

And in fact to add on to what Mr. Leonard just said, this is in our Pennichuck East Utility System which serves 19 communities, none of which is the City of Nashua. They are communities are far north as North Conway, as far east as Lee and Newmarket and a good portion of the center of the State. So that's with respect to that.

The second loan is for \$3.375 million dollars through the Drinking Water & Groundwater Trust Fund. The Drinking & Groundwater Trust Fund was the fund that was established out of the settlement that the State of NH received \$320 million dollars from Exxon Mobile in an MTBE suit that was resolved about a year ago and it established a fund. \$32 million dollars of that went into the State's Rainy Day fund and the remaining \$288 million dollars established this Drinking Water & Groundwater Trust Fund. It was established for purposes of remediation of MTBE contamination and/or other contamination and development of water sources throughout the State.

When we apply, they have actually created a joint application process, when you apply for SRF funds you are apply not only for SRF funds but at the same time they consider whether your projects may be eligible for drinking water and ground water trust fund funding as well. This was a particular petition that we had put in under the SRF program which was not accepted under the SRF program for funding but then was subsequently approved for funding under the Drinking Water & Groundwater Trust Fund and it is specific to water main replacement work within the Nashua core.

Now as you know, we have gone out and we've gotten authority for you to do bonding over the next several years, so why would we want to borrow money for that same purpose? Well there are two things there; this is money that is cheaper as an interest rate and cheaper in closing costs so it actually allows us to leverage at a lower cost some projects within Nashua and actually leave some capacity of the bonding to stretch further into perhaps a fourth year relative to that capacity for projects in Pennichuck Water Works.

So it is a matter of overall funding sources for projects that we do on a regular and on-going basis within the Pennichuck Waterworks Infrastructure replacement projects.

Chairman Wilshire

Excellent are there questions from the committee? You must be doing a good job, no one has questions.

MOTION CARRIED

Chairman Wilshire

If you wanted to address the quarterly report now would be a good time for that.

Mr. Goodhue

Very good. So this is the quarterly report for the first three months of the year. Coincidentally you are going to be getting a report for the first six months of the year very shortly. It is in draft form at this point in time. Just as a reminder, the first 3 months of the year are what we consider base consumption months within the company. If you kind of look at the 4th quarter of our year and the 1st quarter of our year we consider those base consumption; that is where you are really talking about water that is being used for consumptive purposes almost exclusively.

It is in the summer months where water is used for other than consumptive purposes i.e. filling swimming pools, watering lawns, washing cars, whatever it might be. As a result, the lion's share of our revenues are actually attributed within probably the months of June, July, August and September relative to the company. However, a great many of our expenses are more flat lined throughout the year. When you look at interest costs, when you look at cost of wages, you look at the cost of benefits, pension costs, property taxes, things like that. Some of our costs are variable, but a great many of our costs are fixed.

So when you look at this report, it really shows that the first quarter is a little bit interesting to look at. We generated about \$9.3 million dollars in revenue in the 1st quarter of this year which is up from \$8.9 million dollars the prior year. The real difference there is really the full efficacy of the recent rate increase that was brought to bear for the Pennichuck Water Works Subsidiary.

You see our operating costs also go up by about \$400,000.00 in that same year on your comparison and so really our operating income is virtually on par with the first quarter of last year just over a quarter of a million dollars or approximately a quarter of a million dollars.

Our net interest expense is up a bit again, virtually on par with the last year so when you look all the way down to the bottom line, our net loss and our earnings before interest, taxes and depreciation are virtually static year-on-year which you would almost expect to be the case based on a base consumption period of the company's performance year.

If we flip to page 5 of the report and look at the balance sheet, the key items that I focus in on usually is the first line here which is our total property, plant and equipment and as you can see our property, plant and equipment is up by about \$7.5 million dollars year-on-year. That is related to our on-going capital investments that we make in our company, net of depreciation expense that is carried off of that number. As we are fully debt funded you see that there is a movement in our total long-term debt in the current portion of long-term debt however they've gone down. And why is that? Well the debt that we issue at the company now as opposed to what we issued prior to the City's acquisition is all fully amortizing debt. In the past, we used to issue balloon maturity debt. So even though you were making those capital investments, you wouldn't see the debt go down, you would constantly see it going up. What you are seeing here is now some of the efficacy of repayment of principal on an annual basis relative to our debt loan on our capital, which is a positive thing.

The other major thing that changed on the liability side of the balance sheet between December 31st 2017 and March 31st of 2018 is our deferred tax line went from \$20 million down to about \$12 million dollars and that is related to the impact of the new tax act that was enacted by the Federal Government at the end of last year relative to the net impact on deferred taxes from a change in the tax rates.

If we carry forward further, if we look at the cash flow statement on page 7 what you see is that for the first quarter of this year as opposed to the first quarter of last year, our cash provided by operating activities is slightly positive versus majorly negative in the prior year. So if you look at that, that is really the cash basis income that is being generated from our activities in that we have a material shelter against our net income in the form of depreciation and amortization of about \$2 million dollars per quarter relative to depreciation and amortization which is fairly significant.

The other major items on here are payments on long-term debt, as you see, nearly \$3 million dollars was repaid on long-term debt within the first quarter. A good portion of that is actually payments to the City where we continue to make our \$707,000. plus per month in payments including one that was made today relative to the note payment to the City from the acquisition debt for the corporation.

If you look at page 8 and look at some of the capital expenditures the first quarter again it is a ramp up period of time so there is not a lot of activity on the capital side because it is actually kind of in a quiet time relative to capital projects. The second quarter report is going to have more there, the third quarter report will definitely have more there. The construction season started a little slow this year, it is in full swing now and by the end of the third quarter you are going to see a great deal of dollars that have been expended on various projects that we have on-going including the interconnection water main that is being constructed right now across the Merrimack River for our Pennichuck East Utility Subsidiary.

We have the rate case pending for Pennichuck East Utility, in fact at 10:00 a.m. tomorrow morning we are going to be at the Public Utilities Commission for the final hearing for permanent rates for our Pennichuck East Utility rate case. Hopefully that is going to go well; we actually have a settlement agreement in place between the PUC staff, the Office of Consumer Advocate and the Company. So the hearing is based on a settlement agreement and so the commissioners will be opining based upon that already filed settlement agreement and the testimony that is offered tomorrow in support of that. We are hopeful that goes quite expeditiously tomorrow and within the next 45 to 60 days we will have a permanent rate order relative to the resetting of rates for Pennichuck East Utility.

What is important about that is not just the re-setting of rates, but it is the re-setting of the structure. So if you recall for the most recent rate case that we did with Pennichuck Water Works, we did a major modification to the overall rate structure for Pennichuck Waterworks' revenues, it is how those allowed revenues are constructed with the three buckets being the dollars that are needed to pay the City back, the dollars that are needed to support all of our other external debt and the dollars that are needed to pay for operating expenses. So three buckets of revenues, that same structure has been applied in the Pennichuck East Utility Case. So if this passes, it is one more step towards the final resolution of actually having a rate structure that is in full support of our capital structure for on-going and long-term financial security for the company.

Other than that, there is always activities going on at the company relative to compliancy for water quality regulations with the DES and maintaining MCL compliancy, water sampling. We continue our efforts on succession planning at the company, that is making sure that we are training and motivating and securing the services of qualified employees to run the company.

We also have one other process at the PUC which is our annual QCPAC rate case which was a replacement of the WICA surcharge for Pennichuck Waterworks. We are hopeful that we are going to get an order on that fairly soon relative to the QCPAC and that will have an effective date probably sometime in the next couple of months and then that would be there to actually provide the cash for the actual assets that were put in place and used and useful during the calendar year 2017 which we debt financed with a bond issuance on April 4th of this year.

So that is kind of a high level fly over. If there are any specific questions I would be happy to answer them.

Chairman Wilshire

Does anyone have questions? Still doing a good job, no one has got questions. Thank you very much gentlemen, appreciate you being here.

NEW BUSINESS – ORDINANCES – None

PUBLIC COMMENT - None

REMARKS BY THE ALDERMEN - None

POSSIBLE NON-PUBLIC SESSION - None

ADJOURNMENT

**MOTION BY ALDERMAN MCCARTHY TO ADJOURN
MOTION CARRIED**

The meeting was declared closed at 7:18 p.m.

Alderman Patricia Klee
Committee Clerk