



## CREDIT ANALYSIS

## Pennichuck Water Works, Inc.

Merrimack, New Hampshire, United States

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TABLE 1

## Pennichuck Water Works, Inc.

	2008	2008	2010	2011	LTM 9/30/2012
Funds From Operations (FFO) / Debt	11.6%	14.1%	17.2%	19.2%	3.4%
FFO + Interest / Interest	3.3x	3.7x	4.2x	4.4x	1.6x
Debt / Capitalization	53.7%	46.6%	44.1%	41.4%	25.6%
RCF / Capex	0.4x	0.9x	0.8x	1.7x	0.2x

## Company Profile

Pennichuck Water Works, Inc. (PWW, Baa3 senior unsecured, positive outlook) is a relatively small regulated water utility company based in Merrimack, New Hampshire. PWW is currently owned by Pennichuck Corporation (Corp), which also owns two other, considerably smaller water utilities, and has modest-sized investments in non-regulated activities. Corp is owned by the City of Nashua, NH. For the fiscal year-ended December 31, 2011, PWW reported revenues and funds from operations (FFO) of \$28.7 million and \$9.9 million, respectively. PWW also represents approximately 75% of Corp's consolidated revenues (2011).

## Recent Events

On January 25, 2012, the City of Nashua, New Hampshire completed its acquisition of all outstanding common stock of Corp. The stock was purchased for \$29/share and Corp ceases to be publicly traded on the NASDAQ.

This Credit Analysis provides an in-depth discussion of credit rating(s) for Pennichuck Water Works, Inc. and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on [Moody's website](#).

## Rating Rationale

PWW's Baa3 senior unsecured rating reflects the company's stable water utility operations, economically healthy customer base (approximately 67% residential), appropriate credit metrics for its rating category and historically constructive relationship with the New Hampshire Public Utility Commission (NH-PUC). Challenges for the company include its ongoing capital needs and small size, which can leave it negatively exposed to cool, wet weather conditions in any given year.

We note that the issuer of the Moody's rated PWW bonds is a tax-advantaged finance conduit. As background, in October 2005 PWW raised \$50 million of 30-year tax-exempt "Water Facility Revenue Bonds" to help fund capital spending for its rate regulated operations over the next several years. The initial Aaa rating assigned to the \$50 million of bonds, (issued by the Business Finance Authority of the State of New Hampshire) reflected the unconditional and non-cancelable insurance policy provided by AMBAC Assurance Corporation (AMBAC), to provide assurance of timely payment of principal and interest when due. PWW was the underlying obligor and source of cash flows for debt service and repayment of the bonds. Due to a series of downward rating actions on AMBAC, Moody's now views the operative rating assigned to the notes as solely reflecting the credit profile of PWW.

Of the initial \$50 million offering in 2005, approximately \$38 million was utilized to support capital projects in PWW's service area; the centerpiece of which was a \$40 million water treatment project, now complete. The escrow balance of approximately \$11 million was returned to investors on July 1, 2010.

## Small But Stable Regulated Utility Operations

PWW is the largest of Pennichuck Corporation's three regulated water utility subsidiaries, providing service to approximately 26,000 customers in Nashua and 10 surrounding municipalities. However, with just \$28.7 million of revenue in 2011 PWW is extremely small compared to the peer group of regulated water utilities rated by Moody's.

Offsetting the small size is the relative stability expected within the regulated framework. The NH-PUC regulates PWW's rates and the company has been active in recent years in seeking rate increases. In August 2009, the NH-PUC approved a 22% rate increase (\$4.7 million) based on 2007 usage volume. We believe this was a constructive outcome given the elevated capital spending in the preceding years. However, the combination of cooler, wet weather, water conservation, and some economic slowing in 2009 led to reduced volumes, making it difficult for the company to realize the full benefit of the increased rate authorization.

In May 2010, the company sought a further annual increase of \$3.9 million (16.2%) and in June 2011 the NH-PUC authorized an increase of \$2.9 million. Importantly, the order also approved a pilot Water Infrastructure and Conservation Adjustment ("WICA") mechanism that will allow Pennichuck Water to recover, through a rate surcharge between rate cases, certain costs of replacing and rehabilitating aging water infrastructure assets as they are placed into service. Ultimately, we believe this will help to reduce regulatory lag on investment in new pipes and other infrastructure. The WICA charge is expected to allow PWW to increase its rates, based upon approved in-service projects, up to a maximum of 2% per year and 7.5% in total between rate cases beginning in 2013.

### Appropriate Credit Metrics For Rating Category

Two key metrics for PWW are FFO to debt and FFO + interest / interest. For the LTM period ended September 30, 2012 PWW reported ratios of 3.4% and 1.6 times, respectively, for these metrics. These metrics are negatively affected by a non-reoccurring expense related to eminent domain proceedings and adjusting for that one-time expense FFO to debt and FFO + interest / interest are 10.0% and 2.8 times, respectively, for LTM September 30, 2012. The appropriate "Baa" range for these metrics in the regulated water sector would be in the ranges of 10-15% and 2.5-4.5 times, respectively. At the parent level the metrics are just slightly weaker (for example consolidated FFO to debt has averaged 15% at Corp compared to 17% at PWW from 2009-2011). Adding the debt the City of Nashua (Aa2 general obligation rating, stable outlook) raised to finance the purchase of Corp to PWW's metrics FFO to debt and FFO + interest / interest would be 2.5% and 1.7 times for LTM September 30, 2012.

### Takeover By City Of Nashua Completed

Since 2002, the City of Nashua has attempted to acquire the assets of PWW primarily through the use of eminent domain. On November 12, 2010, the City and Corp announced that they had entered into an agreement whereby the city would purchase Corp in its entirety. This government ownership of a corporate entity was made possible by special legislation enacted in 2007. The acquisition closed on January 25, 2012 and the final price of \$29/share or \$138 million. The City of Nashua approved an independent board comprised of 7 to 13 directors to oversee the company. The city does not expect to change the operations of the utility but has reduced the number of executive level corporate employees. We expect the ownership by the City of Nashua to be positive for PWW, as the overhang of the pending acquisition has been resolved, freeing up resources previously dedicated to the takeover now being able to focus on the utility's operations.

### Liquidity

PWW is viewed to have an adequate liquidity profile. Externally, PWW's liquidity is currently supported by the availability of a \$10 million revolving credit facility at the parent level that expires in June 2014. At December 19, 2012, the line was undrawn. Financial covenants associated with the bank line include Fixed Charge Coverage Ratio of 1.0x or greater, and an Equity Capitalization Ratio of 35% or greater. PWW has no maturities until 2018 when \$7.5 million of revenue bonds come due.

### What could Change the Rating Up?

The rating is positive and could be upgraded with the continued successful integration and operation by the City of Nashua. The ultimate number of notches upgraded will depend on our view on the impact, if any, on the Aa2 rating of the City of Nashua.

### What could Change the Rating Down?

Given the recent acquisition by a higher rated entity, a downgrade is unlikely at this time. Though if the unregulated business grew significantly, or if there are major operational disruptions, a downgrade could result.

## Rating Factors

Moody's also views PWW's rating within the context of our "Global Regulated Water Utilities" rating methodology (published December 2009). With this methodology, PWW's mapped unsecured rating is Baa1 using both historical and projected PWW metrics implying some cushion against the current Baa3 unsecured rating. When adding the acquisition debt to the metrics PWW's methodology implied rating falls to Baa3/Baa1. The attached grid details the mapping of PWW's profile to the sub-factors outlined in our methodology.

TABLE 2

### Rating Factors

Pennichuck Water Works, Inc. (LTM Sep-2012)

Global Regulated Water Utilities	Aaa	Aa	A	Baa	Ba	B	Caa
<b>Factor 1: Regulatory Environment and Asset Ownership (40%)</b>							
a) Stability & Predictability of Regulatory Environment				X			
b) Asset Ownership Model			X				
c) Cost and Investment Recovery (Ability and Timeliness)				X			
d) Revenue Risk				X			
<b>Factor 2: Operational Characteristics &amp; Asset Risk (10%)</b>							
a) Operational Efficiency				X			
b) Scale of Capital Program and Asset Condition				X			
<b>Factor 3: Stability of Business Model and Financial Structure (10%)</b>							
a) Ability & Willingness to Pursue Opportunistic Corporate Activity			X				
b) Ability & Willingness to Increase Leverage			X				
c) Proportion of Revenues Outside Core Water and Wastewater		X					
<b>Factor 4: Key Credit Metrics (40%) 3-Yr average</b>							
a) FFO + Interest / Interest				X			
b) Debt / Capitalization		X					
c) FFO / Debt				X			
d) RCF / Capex					X		
<b>Rating:</b>							
Indicated Rating from Methodology							Baa1
Actual Rating Assigned							Baa3

Report Number: 148679

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