PENNICHUCK

March 30, 2015

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 9, 2015 at the Courtyard Marriott, 2200 Southwood Drive, 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.), a service company (Pennichuck Water Service Corporation), and a real estate 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 27,600 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 7,100 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 600 customers in Pittsfield.

Pennichuck Water Service Corporation provides service in connection with the management of water services for two communities; billing, collection and customer services for three communities; and water meter testing services, as well as contracted water services at various levels for approximately 85 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 mission have been developed relative to our water resources, employees, financing, customer services and Company assets. These strategies together with the goals and plans to support the strategies are available on the Company's website, www.pennichuck.com, under the "Company Reports" caption.

The Company currently has 107 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, 2014 are attached to this report.

| | ($ Millions) | | | |
|---|---|---|---|---|
| | 4th Quarter | | Year-to-Date | |
| | 2013 | 2014 | 2013 | 2014 |
| Revenues | $ 8.5 | $ 8.2 | $37.7 | $38.8 |
| Operating Expenses | (7.3) | (7.2) | (30.3) | (29.9) |
| Operating Income | 1.2 | 1.0 | 7.4 | 8.9 |
| Interest Expense | (2.5) | (2.6) | (10.1) | (10.2) |
| Other Income | - | - | 0.9 | - |
| Pre-Tax Income (Loss) | (1.3) | (1.6) | (1.8) | (1.2) |
| Income Tax Expense (Benefit) | (0.9) | 0.6 | (0.8) | 0.6 |
| Net Income (Loss) | (0.4) | (2.2) | (1.0) | (1.8) |
| Dividends Paid to the Shareholder | 0.5 | 0.1 | 0.8 | 0.3 |
| Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) | 2.9 | 2.6 | 15.3 | 15.2 |

- Consolidated revenues for the fourth quarter decreased by $0.3 million from $8.5 million in 2013 to $8.2 million in 2014. The decrease is partially attributable to the lower usage for Pennichuck Water Works, Inc.

- Consolidated year-to-date revenues increased slightly from $37.7 million in 2013 to $38.8 million in 2014. Revenues from the regulated utilities increased due to the approval of permanent rate increases for Pennichuck East Utility, Inc. and Pittsfield Aqueduct Company, Inc. and the recoupment of permanent rates back to July 1, 2013.

- Consolidated operating expenses were essentially flat for the fourth quarter.

- Consolidated operating expenses decreased by $0.4 million from 2013 to 2014 mainly due to the incremental amortization of the Municipal Regulatory Acquisition Asset in 2013.

- An increase in interest expense from 2013 to 2014 of approximately $0.1 million is primarily due to the increased financing of capital projects.

- Approximately $0.9 million was realized in 2013 from the sale of a conservation easement to the Society for the Protection of New Hampshire Forests on land located in Merrimack, NH.

- Pre-tax loss for the fourth quarter increased from $1.3 million in 2013 to $1.6 million in 2014 due to lower revenues and an increase in interest cost associated with the financing of capital projects.

- The pre-tax loss for the year decreased from $1.8 million in 2013 to $1.2 million in 2014 due to the overall increase in revenues and lower operating expenses.

- Dividends paid to the sole shareholder were greater in 2013 as a special dividend in the amount of $0.5 million was paid for recovery of eminent domain costs by the sole shareholder. The dividend was funded by the sale of a conservation easement to the Society for the Protection of New Hampshire Forests.

- Income Tax Expense in the current year reflects the tax treatment for the Municipal Acquisition Regulatory Asset, which is not deductible for tax purposes. Therefore, the year-to-date results reflect a tax provision of approximately -45% of pre-tax income compared to the statutory tax rate expense of 39.6%.

- Earnings Before Interest, Taxes, Depreciation and Amortization decreased in the fourth quarter from $2.9 million in 2013 to $2.6 million in 2014 due to lower revenues.

- Earnings Before Interest, Taxes, Depreciation and Amortization for the years 2013 and 2014 were relatively flat.

## *Unaudited Cash Flow Statement*

Cash Flow on a GAAP basis for the fourth quarter of 2014 as compared to the fourth quarter of 2013, and the year-to-date 2014 versus 2013, are as follows:

| | ($000's) | | | |
|---|---|---|---|---|
| | Quarter Ended | | Year-to-Date | |
| | December 31, 2014 | December 31, 2013 | December 31, 2014 | December 31, 2013 |
| Operating Activities: | | | | |
| Net Income (Loss) | $ (2,236) | $ (425) | $ (1,775) | $ (956) |
| Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by Operating Activities: | | | | |
| Depreciation and Amortization | 1,664 | 1,535 | 6,426 | 6,928 |
| Provision for Deferred Taxes | 633 | (1,104) | 606 | (994) |
| Other | 2 | 15 | 2 | (3) |
| Changes in Assets and Liabilities: | | | | |
| (Increase) Decrease in Accounts Receivable | 1,576 | 1,372 | (195) | (83) |
| (Increase) Decrease in Inventory | 29 | (50) | 18 | (69) |
| (Increase) Decrease in Other Assets | (2,317) | 3,410 | (1,124) | 4,984 |
| Increase (Decrease) in Accounts Payable | (158) | (21) | 557 | 257 |
| Increase (Decrease) in Other Liabilities | 3,506 | (3,816) | 2,833 | (4,081) |
| Net Cash Provided by (Used in) Operating Activities | 2,699 | 916 | 7,348 | 5,983 |
| Investing Activities: | | | | |
| Purchases of Property, Plant & Equipment, including the Debt Component of AFUDC | (3,405) | (2,714) | (8,585) | (7,270) |
| (Increase) Decrease in Restricted Cash | (40,301) | 201 | (40,273) | (120) |
| Change in Deferred Land Costs | - | - | - | (3) |
| Net Cash Provided by (Used in) Investing Activities | (43,706) | (2,513) | (48,858) | (7,393) |
| Financing Activities: | | | | |
| Borrowings (Repayments) on Line of Credit | (3,166) | 1,966 | (1,966) | 1,966 |
| Payments on Long-term Debt | (637) | (574) | (3,036) | (2,835) |
| Contributions in Aid of Construction | 37 | 23 | 78 | 93 |
| Proceeds from Long-term Borrowings | 48,695 | 214 | 49,935 | 3,161 |
| Debt Issuance Costs | (1,018) | 7 | (1,275) | (33) |
| Dividends Paid | (69) | (569) | (277) | (777) |
| Net Cash Provided by (Used in) Financing Activities | 43,842 | 1,067 | 43,459 | 1,575 |
| Increase (Decrease) in Cash and Cash Equivalents | 2,835 | (800) | 1,949 | 165 |
| Cash and Cash Equivalents at Beginning of Period | 152 | 1,838 | 1,038 | 873 |
| Cash and Cash Equivalents at End of Period | $ 2,987 | $ 1,038 | $ 2,987 | $ 1,038 |

## *Balance Sheet*

($000's)

| | As of December 31, 2014 (Audited) | As of December 31, 2013 (Audited) |
|---|---|---|
| Assets: | | |
| Property, Plant & Equipment, Net | $ 173,287 | $ 167,711 |
| Current Assets: | | |
| Cash | 2,987 | 1,038 |
| Restricted Cash | 5,264 | 5,563 |
| Restricted Cash – 2014 Bond Fund Project | 16,847 | - |
| Restricted Cash – Bond Refund Escrow | 23,725 | - |
| Accounts Receivable | 4,631 | 4,437 |
| Inventory | 802 | 820 |
| Other Current Assets Note 1 | 1,682 | 1,562 |
| Total Current Assets | 55,938 | 13,420 |
| Other Assets: | | |
| Acquisition Premium Note 2 | 78,885 | 80,719 |
| Other Assets | 15,697 | 11,350 |
| Total Other Assets | 94,582 | 92,069 |
| TOTAL ASSETS | $ 323,807 | $ 273,200 |
| ***Shareholders' Equity and Liabilities*** | | |
| Shareholders' Equity | $ 24,590 | $ 26,760 |
| Bonds, Notes and Mortgages | 198,032 | 174,431 |
| Current Liabilities: | | |
| Line of Credit | - | 1,966 |
| Current Portion of Long-Term Debt | 26,275 | 2,965 |
| Other Current Liabilities | 2,948 | 2,410 |
| Total Current Liabilities | 29,223 | 7,341 |
| Other Long-Term Liabilities: | | |
| CIAC, net | 36,532 | 34,686 |
| Deferred Income Taxes | 20,334 | 19,807 |
| Accrued Pension Liability Note 3 | 8,017 | 5,257 |
| Other Long-Term Liabilities | 7,079 | 4,918 |
| Total Other Long-Term Liabilities | 71,962 | 64,668 |
| TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES | $ 323,807 | $ 273,200 |

Notes to Balance Sheet

Note 1 (Other Current Assets) – At December 31, 2014, approximately $1,047,000 of this balance is comprised of prepaid property taxes, which were expensed in the first quarter, relating to taxes paid in November and December of 2014 for the second half of the property tax year ended March 31, 2015.

Note 2 – 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 – During 2014, $986,000 was contributed into the Pension Plan, while approximately $429,000 in benefit payments were made to participants and approximately $694,000 of investment income and appreciation was earned in the plan.

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*Capital Expenditures*

Capital expenditures in the fourth quarter of 2014 were $3.3 million compared to $2.6 million in the fourth quarter of 2013. For the year 2014, capital expenditures were $8.0 million as compared to $6.6 million in 2013.

The major expenditures for 2014 were as follows:

| | ($000's) |
|---|---|
| Burke Street Main Replacement (Nashua) | $ 896 |
| Windham Main Replacement (PEU – Windham) | 658 |
| Avery Interconnection (PEU – Londonderry) | 648 |
| Locke Lake Pipe Replacement (PEU – Barnstead) | 620 |
| Asset Management and GIS System Implementation | 617 |
| Snow Station Structural Improvements (Nashua) | 572 |
| Meters (all utilities) | 498 |
| Boston Post Road Main Replacement (Amherst) | 453 |
| Data Presentation (DPaC Work Order Project) | 217 |
| Hardwood Estates Replace Structure (PEU – Derry) | 191 |
| Timberline Pump Station (Nashua) | 153 |
| Liberty Tree – Replacement Structure (PEU – Raymond) | 151 |
| Baldwin Street Main Replacement (Nashua) | 145 |
| Oak Street Main Replacement (Nashua) | 117 |
| Cross Street Main Replacement (Nashua) | 110 |

*Regulated Utilities Rate Cases*

As required in the Public Utilities Commission's (PUC) approval of the Pennichuck acquisition by the City of Nashua, the Pennichuck regulated utilities each filed rate cases simultaneously on May 31, 2013. Filings with the PUC are available on the Company's website, www.Pennichuck.com, under the "Company Reports" caption. The PUC approved a 7% temporary rate increase for Pittsfield Aqueduct Company, Inc. on November 22, 2013 (Order

No. 25,599) and a 7% temporary rate increase for Pennichuck East Utility, Inc. on November 27, 2013 (Order No. 25,602). PUC hearings on permanent rates for each of the regulated utilities were held on May 20, 2014.

On July 15, 2014, the PUC issued Order No. 25,693 indicating that the rate case filed on May 31, 2013 would result in no increase in rates for customers of Pennichuck Water Works, Inc. (PWW). The order approved the extension of the Water Infrastructure and Conservation Adjustment (WICA) program which will be evaluated at the time of PWW's next rate case.

On July 22, 2014, the PUC issued Order No. 25,695 approving a permanent rate increase of 8.95% for customers of Pittsfield Aqueduct Company, Inc. The rate increase is effective for service rendered on or after July 1, 2013.

On July 25, 2014, the PUC issued Order No. 25,696 approving a 9.91% permanent rate increase and a 1.62% step increase for customers of Pennichuck East Utility, Inc. The permanent rate increase is effective for service rendered on or after July 1, 2013. The step increase is effective the date of the order.

*Conservation Easement*

The Company placed 218 acres of land in Merrimack in a permanent conservation easement with the Society for the Protection of New Hampshire Forests on July 18, 2013. Pre-tax income in the amount of $891,000 was recognized by the sale of this easement.

*Water Infrastructure and Conservation Adjustment (WICA)*

On May 5, 2014, the PUC issued Order No. 25,661 approving a WICA surcharge of 0.67% for customers of Pennichuck Water Works, Inc. in the Nashua Core System. The surcharge is effective for service rendered on or after April 1, 2014. The order was effective May 28, 2014.

*Financing*

On April 15, 2014, the PUC approved financing in the amount of $1,522,000 from the State Revolving Fund administered by the Department of Environmental Services for Pennichuck East Utility, Inc. The loans are $400,000 for pipe replacement in the Winwood/Monroe section of the Locke Lake system, $550,000 for pipe replacement in the W&E system in Windham, and $572,000 for a new water system station for the Hardwood system in Windham. The loan documents were executed in the second quarter of 2014.

On April 15, 2014, the PUC approved financing in the amount of $2,970,000 from the State Revolving Fund administered by the Department of Environmental Services for Pennichuck Water Works, Inc. The loans are $330,000 to upgrade the Timberline booster station in Nashua, and $2,640,000 for water pipeline replacement in Nashua and Amherst. The loan documents were executed in the second quarter of 2014.

On May 15, 2014, Pennichuck Water Works, Inc. filed a petition with the PUC relative to its Integrated Capital Finance Plan. The Plan proposed financing of up to $54.5 million for capital expenditures for the years 2013 to 2016 and the refinancing of existing debt. The financing was

approved by the PUC on November 7, 2014. On December 15, 2014, the Company issued bonds in the amount of $47,185,000, of which $23,350,000 was issued relative to debt refinancing, $24,600,000 was issued relative to the financing of capital projects for the years 2013 through 2016, and $(765,000) relates to cost of issuance and bond premium at time of issuance.

On June 25, 2014, Pennichuck Corporation closed on a $10 million line of credit from TD Bank, N.A. The line of credit is available for a two-year period ending on June 25, 2016.

On October 6, 2014, Pennichuck East Utility, Inc. filed a petition with the PUC relative to the financing of capital with CoBank, ACB in the amount of $625,000. The PUC approved the financing on December 30, 2014. The financing closed in March 2015.

On November 14, 2014, Pennichuck East Utility, Inc. filed a petition with the PUC to amend the funding amount for its State Revolving Fund Loan for the W&E System in Windham, increasing the amount from $550,000 to $1,060,000. The PUC approved the financing on January 21, 2015. The financing closed in March 2015.

*Succession Planning*

In July 2013, the Board of Directors extended the employment of John Patenaude as the Company's Chief Executive Officer through November 2015. Mr. Patenaude accepted the Board's offer. As part of the Board's succession planning efforts, the Compensation and Benefits Committee of the Board of Directors and the full Board have adopted a process for selecting a Chief Executive Officer. The CEO Succession Plan Process can be viewed on Pennichuck's website, www.Pennichuck.com, under the "Board of Directors" caption. Mr. Patenaude will retire from the Company in November 2015.

*Company Goals – 2015*

The Company's main goals for 2015 are as follows:

- continue to provide excellent water quality and services;
- continue prudent investments in the aging infrastructure;
- continue investments and training in IT Systems to increase the efficiency of operations;
- market the services of the water service company relative to meter testing and customer billings and services;
- enable a seamless management transition by November 2015; and
- continue to refinance existing bonds which have "balloon" payment requirements.

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

Sincerely,

John L. Patenaude
Chief Executive Officer

# Pennichuck Corporation and Subsidiaries

## Audited Consolidated Financial Statements

## December 31, 2014 and 2013

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# INDEPENDENT AUDITORS' REPORT

Board of Directors and Stockholder
Pennichuck Corporation and Subsidiaries

We have audited the accompanying consolidated financial statements of Pennichuck Corporation and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, 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, 2014 and 2013, 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 18, 2015

**PENNICHUCK CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**
**As of December 31, 2014 and 2013**
**(in thousands, except share data)**

| | 2014 | 2013 |
|---|---|---|
| ASSETS | | |
| Property, Plant and Equipment, net | $ 173,287 | $ 167,711 |
| Current Assets: | | |
| Cash and cash equivalents | 2,987 | 1,038 |
| Restricted cash - RSF | 5,264 | 5,563 |
| Restricted cash - 2014 Bond Project Fund | 16,847 | - |
| Restricted cash - Bond Refund Escrow | 23,725 | - |
| Accounts receivable - billed, net | 2,189 | 2,301 |
| Accounts receivable - unbilled, net | 2,399 | 2,102 |
| Accounts receivable - other | 43 | 34 |
| Inventory | 802 | 820 |
| Prepaid expenses | 541 | 528 |
| Prepaid property taxes | 1,047 | 1,034 |
| Deferred and refundable income taxes | 94 | - |
| Total Current Assets | 55,938 | 13,420 |
| Other Assets: | | |
| Deferred land costs | 2,251 | 2,251 |
| Debt issuance expenses, net | 4,422 | 3,406 |
| Investment in real estate partnership | 104 | 110 |
| Other | 8,920 | 5,583 |
| Acquisition premium, net | 78,885 | 80,719 |
| Total Other Assets | 94,582 | 92,069 |
| TOTAL ASSETS | $ 323,807 | $ 273,200 |

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

**PENNICHUCK CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS - CONTINUED**
**As of December 31, 2014 and 2013**
**(in thousands, except share data)**

| | 2014 | 2013 |
|---|---|---|
| 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 | (6,151) | (4,099) |
| Accumulated other comprehensive income | 180 | 298 |
| Total Stockholder's Equity | 24,590 | 26,760 |
| Long-Term Debt, Less Current Portion | 198,032 | 174,431 |
| Current Liabilities: | | |
| Line of credit | - | 1,966 |
| Current portion of long-term debt | 26,275 | 2,965 |
| Accounts payable | 1,577 | 1,150 |
| Accrued property taxes | - | 13 |
| Deferred revenue | 65 | 66 |
| Accrued interest payable | 682 | 576 |
| Other accrued expenses | 215 | 212 |
| Accrued wages and payroll withholding | 221 | 282 |
| Customer deposits and other | 188 | 111 |
| Total Current Liabilities | 29,223 | 7,341 |
| Other Liabilities and Deferred Credits: | | |
| Deferred income taxes | 20,334 | 19,807 |
| Accrued pension liability | 8,017 | 5,257 |
| Unamortized debt premium | 2,331 | 427 |
| Deferred investment tax credits | 603 | 636 |
| Regulatory liability | 803 | 824 |
| Accrued post-retirement benefits | 2,016 | 1,858 |
| Customer advances | 84 | 84 |
| Contributions in aid of construction, net | 36,532 | 34,686 |
| Derivative instrument | 583 | 386 |
| Other long-term liabilities | 659 | 703 |
| Total Other Liabilities and Deferred Credits | 71,962 | 64,668 |
| TOTAL STOCKHOLDER'S EQUITY AND LIABILITIES | $ 323,807 | $ 273,200 |

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

**PENNICHUCK CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF INCOME**
**For the Years Ended December 31, 2014 and 2013**
**(in thousands)**

| | 2014 | 2013 |
|---|---|---|
| Operating Revenues | $ 38,815 | $ 37,694 |
| Operating Expenses: | | |
| Operations and maintenance | 18,221 | 18,523 |
| Depreciation and amortization | 6,148 | 6,661 |
| Taxes other than income taxes | 5,541 | 5,072 |
| Total Operating Expenses | 29,910 | 30,256 |
| Operating Income | 8,905 | 7,438 |
| Interest Expense | (10,156) | (10,128) |
| Allowance for Funds Used During Construction | 7 | 14 |
| Other, Net | 20 | 872 |
| Loss Before (Provision for) Benefit from Income Taxes | (1,224) | (1,804) |
| (Provision for) Benefit from Income Taxes | (551) | 848 |
| Net Loss | $ (1,775) | $ (956) |

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

**PENNICHUCK CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**For the Years Ended December 31, 2014 and 2013**
**(in thousands)**

| | 2014 | 2013 |
|---|---|---|
| Net Loss | $ (1,775) | $ (956) |
| Other Comprehensive Income: | | |
| Unrealized gain (loss) on derivatives | (349) | 283 |
| Reclassification of net loss realized in net income | 152 | 156 |
| Income tax expense (benefit) relating to other comprehensive income | 79 | (176) |
| Other Comprehensive Income (Loss) | (118) | 263 |
| Comprehensive Loss | $ (1,893) | $ (693) |

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

**PENNICHUCK CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDER'S EQUITY**
**(in thousands, except per share data)**

| | Common Stock | | Additional Paid in | Retained | Accumulated Other Comprehensive | |
|---|---|---|---|---|---|---|
| | Shares | Amount | Capital | Earnings/(Deficit) | Income (Loss) | Total |
| Balance as of January 1, 2014 | 1,000 | $ - | $ 30,561 | $ (4,099) | $ 298 | $ 26,760 |
| Common dividends declared- $276.554 per share | - | - | - | (277) | - | (277) |
| Net loss | - | - | - | (1,775) | - | (1,775) |
| Other comprehensive income (loss): | | | | | | |
| Unrealized loss on derivatives, net of taxes of $(140) | - | - | - | - | (209) | (209) |
| Reclassification of net loss realized in net income, net of taxes of $61 | - | - | - | - | 91 | 91 |
| Balance as of December 31, 2014 | 1,000 | $ - | $ 30,561 | $ (6,151) | $ 180 | $ 24,590 |

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

**PENNICHUCK CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDER'S EQUITY**
**(in thousands, except per share data)**

| | Common Stock | | Additional Paid in | Retained | Accumulated Other Comprehensive | |
|---|---|---|---|---|---|---|
| | Shares | Amount | Capital | Earnings/(Deficit) | Income (Loss) | Total |
| Balance as of January 1, 2013 | 1,000 | $ - | $ 30,561 | $ (2,366) | $ 35 | $ 28,230 |
| Common dividends declared- $777.410 per share | - | - | - | (777) | - | (777) |
| Net loss | - | - | - | (956) | - | (956) |
| Other comprehensive income (loss): | | | | | | |
| Unrealized gain on derivatives, net of taxes of $113 | - | - | - | - | 170 | 170 |
| Reclassification of net loss realized in net income, net of taxes of $63 | - | - | - | - | 93 | 93 |
| Balance as of December 31, 2013 | 1,000 | $ - | $ 30,561 | $ (4,099) | $ 298 | $ 26,760 |

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, 2014 and 2013**
**(in thousands)**

| | 2014 | 2013 |
|---|---|---|
| Operating Activities: | | |
| Net Loss | $ (1,775) | $ (956) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 6,447 | 6,949 |
| Amortization of original issue discount | 12 | 12 |
| Equity component of AFUDC | (4) | (8) |
| Amortization of deferred investment tax credits | (33) | (33) |
| Provision for deferred income tax | 606 | (994) |
| Undistributed loss in real estate partnership | 6 | 5 |
| Changes in assets and liabilities: | | |
| Increase in accounts receivable billed and unbilled | (195) | (83) |
| (Increase) decrease in inventory | 18 | (69) |
| (Increase) in prepaid expenses | (120) | (196) |
| (Increase) decrease in deferred charges and other assets | (1,004) | 5,180 |
| Decrease in refundable income taxes | 1 | 155 |
| Increase in accounts payable and deferred revenue | 557 | 257 |
| Increase (decrease) in accrued interest payable | 106 | (42) |
| Increase (decrease) in other | 2,726 | (4,194) |
| Net cash provided by operating activities | 7,348 | 5,983 |
| Investing Activities: | | |
| Purchase of property, plant and equipment including debt component of allowance for funds used during construction | (8,585) | (7,270) |
| Increase in restricted cash | (40,273) | (120) |
| Change in investment in real estate partnership and deferred land costs | - | (3) |
| Net cash used in investing activities | $ (48,858) | $ (7,393) |

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, 2014 and 2013**
**(in thousands)**

| | 2014 | 2013 |
|---|---|---|
| Financing Activities: | | |
| Borrowings (payments) on line of credit, net | $ (1,966) | $ 1,966 |
| Payments on long-term debt | (3,036) | (2,835) |
| Contributions in aid of construction | 78 | 93 |
| Proceeds from long-term borrowings | 49,935 | 3,161 |
| Debt issuance costs | (1,275) | (33) |
| Dividends paid | (277) | (777) |
| Net cash provided by financing activities | 43,459 | 1,575 |
| Increase in cash and cash equivalents | 1,949 | 165 |
| Cash and cash equivalents, beginning of period | 1,038 | 873 |
| Cash and cash equivalents, end of period | $ 2,987 | $ 1,038 |

**Supplemental Disclosure on Cash Flow and Non-cash Items**
**For the Years Ended December 31, 2014 and 2013 (in thousands)**

| | 2014 | 2013 |
|---|---|---|
| Cash paid during the period for: | | |
| Interest | $ 9,809 | $ 9,937 |
| Income taxes | 93 | 81 |
| Non-cash items: | | |
| Contributions in aid of construction | 2,586 | 1,825 |
| Forgiveness of debt | 75 | 56 |

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

## PENNICHUCK CORPORATION AND SUBSIDIARIES
## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**Description of Business:**

Pennichuck Corporation (our "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.

Our Company's utility subsidiaries are engaged principally in the collection, storage, treatment and distribution of potable water to approximately 35,400 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 our Company and its wholly owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation.

***Use of Estimates in the Preparation of Financial Statements***

The preparation of 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 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 our 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 New Hampshire Public Utilities Commission ("NHPUC") Order 25,292, as explained more fully in Note 11 of these financial statements. The RSF is an imprest fund of $5,000,000, 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. Of the approximately $5.3 million in restricted cash as of December 31, 2014 and in compliance with the rules governing the use of the RSF, approximately $263,000 is reserved as a potential return to rate payers as a component of the new water rates set as a result of the next promulgated rate case before the NHPUC, for which that timing and occurrence is yet to be determined.

***Restricted Cash – 2014 Bond Project Fund***

This restricted cash balance consists of funds that resulted from the issuance of the Series 2014A tax-exempt bonds in December of 2014, as notated and fully described in Note 9 of these audited financial statements. The new money proceeds, as described in Note 9, from that bond issuance are maintained in a separate restricted cash account, and are subject to withdrawal as a reimbursement of eligible capital project expenditures for the years 2014 through 2016, as defined by the indenture and issuance documents associated with the offering. This fund was initially funded at a level of $19.5 million, at the time the bonds were issued. In December of 2014, the first reimbursement withdrawal was processed from this fund, in the amount of approximately $2.7 million, as a reimbursement of qualifying capital projects completed and "used and useful" during 2014, resulting in the December 31, 2014 balance in the fund of approximately $16.8 million.

***Restricted Cash – Bond Refund Escrow***

This restricted cash balance also consists of funds that resulted from the issuance of the Series 2014A tax-exempt bonds in December of 2014, as notated and fully described in Note 9 of these audited financial statements. The refinance money proceeds, as described in Note 9, from that bond issuance are maintained in a separate restricted cash account, pending the completion of the refinance of existing tax-exempt bonds on January 20, 2015, the date at which the required 30-day notice period to bondholders has expired from the date of notification after the close of the December 15, 2014 bond closing. As of January 20, 2015, the entire balance in this account, which included $23,350,000 of principal due on the bonds being refunded, as well as approximately $375,000 of accrued interest due on these bonds, was paid out to the holders of those debt instruments.

***Concentration of Credit Risks***

Financial instruments that subject our Company to credit risk consist primarily of cash and accounts receivable. Our cash balances are invested in a financial institution insured to statutory limit by the Federal Deposit Insurance Corporation ("FDIC"). 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***

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***

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, using the average cost method, or market.

***Deferred Land Costs***

Included in deferred land costs is our Company's original basis in its undeveloped land-holdings 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, 2014 and 2013.

***Deferred Charges and Other Assets***

Deferred charges include certain regulatory assets and costs of obtaining debt financing. Regulatory assets are amortized over the periods they are recovered through NHPUC-authorized water rates. Deferred financing costs are amortized over the term of the related bonds and notes. Our 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 3 to 25 years.

***Contributions in Aid of Construction ("CIAC")***

Under construction contracts with real estate developers and others, our Company's utility subsidiaries may receive non-refundable advances for the cost of installing new water mains. These advances are recorded as 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 property.

***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 our 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 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. Our 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 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.

***Recently Issued Accounting Standards***

We do not expect the adoption of any recently issued accounting pronouncements to have a material impact on our financial condition or results of operations.

**Note 2 – Property, Plant and Equipment**

The components of property, plant and equipment as of December 31, 2014 and 2013 were as follows:

| (in thousands) | 2014 | 2013 | Useful Lives (in years) |
|---|---|---|---|
| Utility Property: | | | |
| Land and land rights | $ 2,939 | $ 2,927 | - |
| Source of supply | 51,489 | 50,399 | 3 - 75 |
| Pumping and purification | 30,115 | 29,775 | 14 - 64 |
| Transmission and distribution, including services, meters and hydrants | 130,983 | 124,024 | 15 - 91 |
| General and other equipment | 11,358 | 10,142 | 7 - 75 |
| Intangible plant | 770 | 768 | 20 |
| Construction work in progress | 2,677 | 2,524 | |
| Total utility property | 230,331 | 220,559 | |
| Total non-utility property | 5 | 5 | 5 - 10 |
| Total property, plant and equipment | 230,336 | 220,564 | |
| Less accumulated depreciation | (57,049) | (52,853) | |
| Property, plant and equipment, net | $ 173,287 | $ 167,711 | |

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 2.45% in 2014 and 2013, respectively.

## Note 3 – Accounts Receivable

Accounts receivable consisted of the following at December 31, 2014 and 2013:

| (in thousands) | 2014 | 2013 |
|---|---|---|
| Accounts receivable - billed | $ 2,240 | $ 2,345 |
| Less allowance for doubtful accounts | (51) | (44) |
| Accounts Receivable - billed, net | $ 2,189 | $ 2,301 |
| Accounts receivable - unbilled | $ 2,399 | $ 2,102 |
| Less allowance for doubtful accounts | - | - |
| Accounts Receivable - unbilled, net | $ 2,399 | $ 2,102 |

## Note 4 – Deferred Charges and Other Assets

Deferred charges and other assets as of December 31, 2014 and 2013 consisted of the following:

| (in thousands) | 2014 | 2013 | Recovery Period (in years) |
|---|---|---|---|
| Regulatory assets: | | | |
| Source development charges | $ 708 | $ 764 | 5 - 25 |
| Miscellaneous studies | 1,080 | 852 | 3 - 25 |
| Unrecovered pension and post-retirement benefits expense | 6,483 | 3,342 | [1] |
| Total regulatory assets | 8,271 | 4,958 | |
| Supplemental executive retirement plan asset | 649 | 625 | |
| Subtotal | 8,920 | 5,583 | |
| Debt issuance expenses | 4,422 | 3,406 | [1] |
| Total deferred charges and other assets | $ 13,342 | $ 8,989 | |

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

## Note 5 – Post-retirement Benefit Plans

### Pension Plan and Other Post-retirement Benefits

We have 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 compensa-

tion levels. Our 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.

We provide post-retirement medical benefits 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. The OPEB Plans are funded from the general assets of our Company.

Upon retirement, if a qualifying employee elects to receive medical benefits under one of our OPEB Plans, we pay up to a maximum monthly benefit of $322 based on years of service.

The following table sets forth information regarding our DB Plan and our OPEB Plans as of December 31, 2014 and for the year then ended:

| (in thousands) | DB Plan | OPEB Plans |
|---|---|---|
| Projected benefit obligations | $ 21,512 | $ 3,000 |
| Employer contribution | 986 | - |
| Benefits paid, excluding expenses | (429) | (34) |
| Fair value of plan assets | 13,495 | 962 |
| Accumulated benefit obligation | 19,374 | - |
| Funded status | (8,017) | (2,038) |
| Net periodic benefit cost | 893 | 130 |
| Amount of the funded status recognized in the Consolidated Balance Sheet consisted of: | | |
| Current liability | $ - | $ (22) |
| Non-current liability | (8,017) | (2,016) |
| Total | $ (8,017) | $ (2,038) |

The following table sets forth information regarding our DB Plan and our OPEB Plans as of December 31, 2013 for the year then ended:

| (in thousands) | DB Plan | OPEB Plans |
|---|---|---|
| Projected benefit obligations | $ 17,501 | $ 2,809 |
| Employer contribution | 911 | 22 |
| Benefits paid, excluding expenses | (410) | (36) |
| Fair value of plan assets | 12,244 | 944 |
| Accumulated benefit obligation | 15,665 | - |
| Funded status | (5,257) | (1,879) |
| Net periodic benefit cost | 1,372 | 204 |
| | | |
| Amount of the funded status recognized in the Consolidated Balance Sheet consisted of: | | |
| Current liability | $ - | $ (21) |
| Non-current liability | (5,257) | (1,858) |
| Total | $ (5,257) | $ (1,879) |

Changes in plan assets and benefit obligations recognized in regulatory assets, for the year ended December 31, 2014, were as follows:

| (in thousands) | DB Plan | OPEB Plans |
|---|---|---|
| Regulatory asset balance, beginning of period | $ 3,815 | $ (473) |
| Net actuarial loss incurred during the period | 2,986 | 299 |
| Prior service cost incurred during the period | - | (51) |
| Recognized net actuarial (gain)/loss | (133) | 40 |
| Regulatory asset balance, end of period | $ 6,668 | $ (185) |

Changes in plan assets and benefit obligations recognized in regulatory assets, for the year ended December 31, 2013, were as follows:

| (in thousands) | DB Plan | OPEB Plans |
|---|---|---|
| Regulatory asset balance, beginning of period | $ 7,874 | $ 222 |
| Net actuarial gain incurred during the period | (3,641) | (699) |
| Recognized net actuarial (gain)/loss | (418) | 4 |
| Regulatory asset balance, end of period | $ 3,815 | $ (473) |

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, 2014:

| (in thousands) | DB Plan | OPEB Plans |
|---|---|---|
| Net actuarial (gain)/loss | $ 6,668 | $ 28 |
| Prior service cost | - | (213) |
| Regulatory asset | $ 6,668 | $ (185) |

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, 2013:

| (in thousands) | DB Plan | OPEB Plans |
|---|---|---|
| Net actuarial (gain)/loss | $ 3,815 | $ (311) |
| Prior service cost | - | (162) |
| Regulatory asset | $ 3,815 | $ (473) |

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

| | 2014 | 2013 |
|---|---|---|
| Discount rate for net periodic benefit cost, beginning of year | 4.84% | 4.00% |
| Discount rate for benefit obligations, end of year (a) | 3.85% | 4.84% |
| Expected return on plan assets for the period (net of investment expenses) | 7.50% | 7.50% |
| Rate of compensation increase, beginning of year | 2.75% | 2.75% |
| Healthcare cost trend rate (applicable only to OPEB Plans) | 9.00% | 9.50% |

(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, 2014, for the DB Plan and the OPEB Plans of approximately $1.59 million and $242 thousand, respectively.

The estimated net actuarial loss for our DB Plan that will be amortized in 2015 from the regulatory assets into net periodic benefit costs is $332,000. The estimated net actuarial gain and prior service cost for our OPEB Plans that will be amortized in 2015 from the regulatory assets into net periodic benefit costs are $(2,000), and $(87,000), respectively.

In establishing its investment policy, our 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 Plan are invested in accordance with the asset allocation range targets to achieve our expected return on Plan assets. Our Company's investment strategy applies to its OPEB Plans as well as the DB Plan. Our 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. We maintain our VEBA plan assets in directed trust accounts at a commercial bank.

The investment strategy for our DB Plan and our 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, 2014, as well as the targeted allocation range:

| | DB Plan | | OPEB Plans | |
|---|---|---|---|---|
| | | Asset Allocation Range | | Asset Allocation Range |
| Equities | 61% | 30% - 100% | 71% | 30% - 100% |
| Fixed income | 39% | 20% - 70% | 28% | 0% - 50% |
| Cash and cash equivalents | 0% | 0% - 15% | 1% | 0% - 15% |
| Total | 100% | | 100% | |

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, 2013, as well as the targeted allocation range:

| | DB Plan | | OPEB Plans | |
|---|---|---|---|---|
| | | Asset Allocation Range | | Asset Allocation Range |
| Equities | 64% | 30% - 100% | 70% | 30% - 100% |
| Fixed income | 36% | 20% - 70% | 28% | 0% - 50% |
| Cash and cash equivalents | 0% | 0% - 15% | 2% | 0% - 15% |
| Total | 100% | | 100% | |

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 have realized 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 financial statements subsequent to those respective dates.

Investments in 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 per unit of participation in the fund and 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 Plans' 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.

We use a fair value hierarchy 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 fair value of DB Plan and OPEB Plan assets by levels within the fair value hierarchy used as of December 31, 2014 was as follows:

| (in thousands) | Totals | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **DB Plan:** | | | | |
| Equities: | | | | |
| Pooled separate accounts | $ 8,204 | $ - | $ 8,204 | $ - |
| Fixed Income: | | | | |
| General investment account | 2,625 | - | - | 2,625 |
| Pooled separate accounts | 2,666 | - | 2,666 | - |
| Total Pension Plan | $ 13,495 | $ - | $ 10,870 | $ 2,625 |

| (in thousands) | Totals | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **OPEB Plans:** | | | | |
| Mutual funds: | | | | |
| Balanced/hybrid funds | $ 173 | $ 173 | $ - | $ - |
| U.S. equity securities funds | 447 | 447 | - | - |
| International equity funds | 66 | 66 | - | - |
| Fixed income funds | 269 | 269 | - | - |
| Cash and cash equivalents: | | | | |
| Money market funds | 7 | - | 7 | - |
| Total Post-retirement Plans | $ 962 | $ 955 | $ 7 | $ - |
| Totals | $ 14,457 | $ 955 | $ 10,877 | $ 2,625 |

The fair value of DB Plan and OPEB Plan assets by levels within the fair value hierarchy used as of December 31, 2013 was as follows:

| (in thousands) | Totals | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **DB Plan:** | | | | |
| Equities: | | | | |
| Pooled separate accounts | $ 7,895 | $ - | $ 7,895 | $ - |
| Fixed Income: | | | | |
| General investment account | 2,940 | - | - | 2,940 |
| Pooled separate accounts | 1,409 | - | 1,409 | - |
| Total Pension Plan | $ 12,244 | $ - | $ 9,304 | $ 2,940 |
| **OPEB Plans:** | | | | |
| Mutual funds: | | | | |
| Balanced/hybrid funds | $ 168 | $ 168 | $ - | $ - |
| U.S. equity securities funds | 416 | 416 | - | - |
| International equity funds | 76 | 76 | - | - |
| Fixed income funds | 261 | 261 | - | - |
| Cash and cash equivalents: | | | | |
| Money market funds | 23 | - | 23 | - |
| Total Post-retirement Plans | $ 944 | $ 921 | $ 23 | $ - |
| Totals | $ 13,188 | $ 921 | $ 9,327 | $ 2,940 |

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 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) | 2014 | 2013 |
|---|---|---|
| Balance, beginning of year | $ 2,940 | $ 1,704 |
| Plan transfers | (494) | 864 |
| Contributions | 537 | 729 |
| Benefits paid | (438) | (410) |
| Return on plan assets (net of investment expenses) | 80 | 53 |
| Balance, end of year | $ 2,625 | $ 2,940 |

In order to satisfy the minimum funding requirements of the Employee Retirement Income Security Act of 1974, applicable to defined benefit pension plans, we anticipate that we will contribute approximately $1.2 million to the DB Plan in 2015.

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 |
|---|---|---|
| 2015 | $ 586 | $ 64 |
| 2016 | 686 | 70 |
| 2017 | 743 | 75 |
| 2018 | 829 | 91 |
| 2019 | 962 | 116 |
| 2020 - 2024 | 5,965 | 645 |
| Total | $ 9,771 | $ 1,061 |

Because we are subject to regulation in the state in which we operate, 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, we have a defined contribution plan covering substantially all employees. Under this plan, our 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 $207,000 and $197,000 for the years ended December 31, 2014 and 2013, respectively.

## Note 6 - Commitments and Contingencies

*Operating Leases*

We lease our corporate office space as well as certain office equipment under operating lease agreements. Total rent expense was approximately $315,000 and $305,000 for the years ended December 31, 2014 and 2013, respectively.

Our remaining non-cancelable lease commitments for our corporate office space and leased equipment as of December 31, 2014 were as follows:

| (in thousands) | Amount |
|---|---|
| 2015 | $ 277 |
| 2016 | 271 |
| 2017 | 159 |
| 2018 | 2 |
| Total | $ 709 |

## Note 7 – 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 have realized 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 financial statements subsequent to those respective dates.

We use a fair value hierarchy 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, 2014 and 2013 were as follows:

| | December 31, 2014 | | | |
|---|---|---|---|---|
| (in thousands) | Total | Level 1 | Level 2 | Level 3 |
| Interest rate swap | $ (583) | $ - | $ (583) | $ - |

| | December 31, 2013 | | | |
|---|---|---|---|---|
| (in thousands) | Total | Level 1 | Level 2 | Level 3 |
| Interest rate swap | $ (386) | $ - | $ (386) | $ - |

The carrying value of certain financial instruments included in the accompanying Consolidated Balance Sheets, along with the related fair value, as of December 31, 2014 and 2013 was as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| (in thousands) | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Liabilities: | | | | |
| Long-term debt | $ (224,307) | $ (270,191) | $ (177,396) | $ (197,797) |
| Interest rate swap liability | (583) | (583) | (386) | (386) |

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 our interest rate swap represents the estimated cost to terminate this agreement as of December 31, 2014 and 2013 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 8 – Income Taxes**

The components of the federal and state income tax provision (benefit) as of December 31, 2014 and 2013 were as follows:

| (in thousands) | 2014 | 2013 |
|---|---|---|
| Federal | $ 343 | $ (623) |
| State | 241 | (192) |
| Amortization of investment tax credits | (33) | (33) |
| Total | $ 551 | $ (848) |
| Current | $ (33) | $ - |
| Deferred | 584 | (848) |
| Total | $ 551 | $ (848) |

The following is a reconciliation between the statutory federal income tax rate and the effective income tax rate for 2014 and 2013:

| | 2014 | 2013 |
|---|---|---|
| Statutory federal rate | 34.0% | 34.0% |
| State tax rate, net of federal benefits | 5.6% | 5.6% |
| Permanent differences | -87.3% | 5.6% |
| Amortization of investment tax credits | 2.7% | 1.8% |
| Effective tax rate | -45.0% | 47.0% |

The temporary items that give rise to the net deferred tax liability as of December 31, 2014 and 2013 were as follows:

| (in thousands) | 2014 | 2013 |
|---|---|---|
| Liabilities: | | |
| Property-related, net | $ 25,626 | $ 24,735 |
| Pension deferred asset | 2,641 | 1,511 |
| Other | 1,061 | 705 |
| Total liabilities | 29,328 | 26,951 |
| Assets: | | |
| Pension accrued liability | 3,176 | 2,082 |
| Net operating loss carryforward | 2,399 | 2,053 |
| Alternative minimum tax credit | 476 | 384 |
| NH Business Enterprise Tax credits | 369 | 250 |
| Other | 2,574 | 2,375 |
| Total assets | 8,994 | 7,144 |
| Net non-current deferred income tax liability | $ 20,334 | $ 19,807 |

We had a federal net operating loss in 2014 and 2013 in the amounts of approximately $1.8 million and $319,000, respectively. The federal tax benefit of the cumulative net operating loss is approximately $2.1 million which begins to expire in 2032, and is included in deferred income taxes in the consolidated balance sheet as of December 31, 2014.

As of December 31, 2014 and 2013, we estimated approximately $476,000 and $384,000 of cumulative federal alternative minimum tax credits that may be carried forward indefinitely as a credit against our regular tax liability.

As of December 31, 2014 and 2013, we had New Hampshire Business Enterprise Tax ("NHBET") credits of approximately $369,000 and $250,000, respectively. NHBET credits begin to expire in 2017. We anticipate that we will fully utilize these NHBET credits before they expire; therefore we have not recorded a valuation allowance related to these credits.

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

We had a regulatory liability related to income taxes of approximately $803,000 and $825,000 as of December 31, 2014 and 2013, 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.

We made a review of our portfolio of uncertain tax positions. In this regard, an uncertain tax position represents our 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, we determined that we had no material uncertain tax positions. We will use tax planning strategies, if required, and when possible, to avoid the expiration of any future net operating loss and/or tax credits.

We file income tax returns in the U.S. federal jurisdiction, the State of New Hampshire and the Commonwealth of Massachusetts. Our 2010 through 2013 tax years remain subject to examination by the Internal Revenue Service. Our tax year 2009 was audited by the Internal Revenue Service and the year was closed with no changes. Our 2008 through 2013 tax years remain subject to examination by one or more state jurisdictions.

Our 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 or penalties during the years ended December 31, 2014 and 2013.

## Note 9 – Debt

Long-term debt as of December 31, 2014 and 2013 consisted of the following:

| (in thousands) | 2014 | 2013 |
|---|---|---|
| Unsecured note payable to City of Nashua, 5.75%, due 12/25/2041 | $ 114,651 | $ 116,336 |
| Unsecured senior note payable due to an insurance company 7.40%, due March 1, 2021 | 4,800 | 5,200 |
| Unsecured Business Finance Authority: | | |
| Revenue Bonds (Series 2014A), interest rates from 3.00% to 4.125%, due January 1, 2016 through January 1, 2045 | 41,885 | - |
| Revenue Bonds (Series 2014B), 4.50%, due January 1, 2045 | 5,300 | - |
| Revenue Bond (2005 Series BC-4), 5.375%, due October 1, 2035 | 12,125 | 12,125 |
| Revenue Bond (2005 Series BC-3), 5.00%, due April 1, 2018 | 7,475 | 7,475 |
| Revenue Bond (2005 Series A), 4.70%, due October 1, 2035 | 12,100 | 12,125 |
| Revenue Bond (Series 2005A), 4.70%, due January 1, 2035 | 1,765 | 1,785 |
| Revenue Bond (Series 2005B), 4.60%, due January 1, 2030 | 2,310 | 2,320 |
| Revenue Bond (Series 2005C), 4.50%, due January 1, 2025 | 1,175 | 1,175 |
| Revenue Bond, 1997, 6.30%, due May 1, 2022 | 2,600 | 2,800 |
| Unsecured notes payable to bank, floating-rate, due March 1, 2030 | 3,708 | 3,886 |
| Unsecured notes payable to bank, 3.62%, due June 20, 2023 | 1,633 | 1,694 |
| Unsecured notes payable to bank, 4.25%, due June 20, 2033 | 880 | 910 |
| Unsecured New Hampshire State Revolving Fund ("SRF") notes (1) | 12,152 | 9,829 |
| Total long-term debt | 224,559 | 177,660 |
| Less current portion | (26,275) | (2,965) |
| Less original issue discount | (252) | (264) |
| Total long-term debt, net of current portion | $ 198,032 | $ 174,431 |

(1) SRF notes are due through 2035 at interest rates ranging from 1% to 4.488%. 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, 2014 are as follows:

| (in thousands) | Amount |
|---|---|
| 2015 | $ 26,275 |
| 2016 | 4,116 |
| 2017 | 4,313 |
| 2018 | 4,504 |
| 2019 | 4,714 |
| 2020 and thereafter | 180,637 |
| Total | $ 224,559 |

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, 2014 and 2013, Pennichuck Water's net worth was $127.8 and $125.6 million, respectively. Pennichuck Water Works also has debt issuance covenants whereby they must also maintain a maximum total debt to capital ratio of 65%, a maximum funded debt to net property, plant and equipment ratio of 60%, and an interest coverage ratio of at least 1.5; at December 31, 2014 and 2013 the total debt to capital ratio was 37% and 29%, respectively, the funded debt to net property, plant and equipment ratio was 55% and 38%, respectively, and the interest coverage ratio was 2.81 and 2.62, respectively.

On December 15, 2014, Pennichuck Water issued tax-exempt Series 2014A (AMT) bonds and taxable Series 2014B bonds, in the amounts of $41,885,000 and $5,300,000, respectively. The Series 2014A bonds, which were issued at a premium of approximately $1.9 million, include money raised to finance capital projects for the years 2014 through 2016 in the amount of $19.5 million, the refinance and refunding of the Series 2005C, Series BC-3, Series BC-4 and 1997 bonds (collectively the "refinanced bonds") included in the table above in the amount of $23.375 million, and the cost of issuance associated with this new series of debt obligations. The refinanced bonds are offset in total by the amount of cash held in the Restricted Cash – Bond Refund Escrow account, as fully described in Note 1 to these financial statements. The associated bond premium for the Series 2014A bonds is being amortized over the lives of the underlying bond obligations. The Series 2014 bonds, which were issued at par, includes $5.1 million to reimburse Pennichuck Water for capital projects completed in calendar year 2013 and January 2014, and originally funded from working capital or line of credit borrowings from the Company's bank, as well as the associated cost of issuance for this series of bonds. The cost of issuance associated with both the Series 2014A and Series 2014B bonds is being amortized over the 30-year life of the debt obligations.

These bonds were issued under a new bond indenture and loan and trust agreement, 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, 2014, Pennichuck Water Works has a Debt to Capital Coverage ratio of 0.4.

**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 11 of these audited 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, 2014, this coverage ratio was 0.5. Also the ratio of EBITDA to the Max Amount Due must be equal to or greater than 1.1; as of December 31, 2014, this ratio was 4.0.

**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 EBITA to Amounts Paid must be equal to or greater than 1.1; as of December 31, 2014, the Rate Covenant coverage ratio was 3.52.

Pennichuck East's loan agreement for its unsecured notes payable to a bank of $3.7 million and $3.9 million at December 31, 2014 and 2013, respectively, contains a minimum debt service coverage ratio requirement of 1.25. At December 31, 2014 and 2013 this ratio was 1.83 and 1.42, respectively. Also, Pennichuck East is required to maintain a maximum ratio of total debt to total capitalization of 65%; at December 31, 2014 and 2013 this ratio was 44% and 41%, respectively.

The Company's revolving credit loan facility with TD Bank contains a covenant that requires the Company to maintain a minimum fixed charge coverage ratio of at least 1.0; at December 31, 2014 and 2013 the fixed charge coverage ratio was 1.12 and 1.08, respectively. The Company is also required to maintain an equity capitalization ratio of not less than 35%; at December 31, 2014 and 2013, the equity capitalization ratio was 41% and 50%, respectively. Under this agreement the Company is also precluded from declaring or paying dividends, or making any other payment or distribution of its equity without the bank's prior written consent, except for: (1) its obligations under Rate Order No. 25,292 as it pertains to the Company's specific obligations under the City Bond Fixed Revenue Requirement ("CBFRR") which provides for payments of approximately $707,000 per month of the note payable to the City of Nashua (the "City"), and quarterly dividends to the City for the remainder of this annual obligation, as defined by the order; and (2) a specific allowance, under Rate Order No. 25,292, whereby the Company is allowed to make distributions to the City from current earnings and profits in excess of the CBFRR, to provide funds to allow the City to reimburse itself for the costs incurred by the City relating to its efforts in pursuing the eminent domain proceedings from January 2002 through August 2009, provided however that such amount shall not exceed $500,000 in any fiscal year, or $5,000,000 in the aggregate, of all such distributions. During the year ended December 31, 2013, a special dividend of $500,000 was approved and paid relating to this. No special dividend was declared or paid in 2014.

Our short-term borrowing activity under this revolving credit loan facility for the years ended December 31, 2014 and 2013 was:

| (in thousands) | 2014 | 2013 |
|---|---|---|
| Established line as of December 31, | $ 10,000 | $ 10,000 |
| Maximum amount outstanding during period | 5,446 | 1,966 |
| Average amount outstanding during period | 2,833 | 137 |
| Amount outstanding as of December 31, | - | 1,966 |
| Weighted average interest rate during period | 0.10% | 1.06% |
| Interest rate as of December 31, | 1.981% | 2.665% |

As of December 31, 2014 and 2013, we had a $3.7 million and $3.9 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 $3.7 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, 2014. 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, 2014 and 2013, included in our Consolidated Balance Sheets under "Deferred credits and other reserves" as "Other liabilities" was $583,000 and $386,000, respectively. Changes in the fair value of this derivative were deferred in accumulated other comprehensive income (loss).

Swap settlements are recorded in the statement of income with the hedged item as interest expense. During the years ended December 31, 2014 and 2013 $152,000 and $156,000 was reclassified pre-tax from accumulated other comprehensive income (loss) to interest expense as a result of swap settlements. We expect to reclassify approximately $143,000, pre-tax, from accumulated other comprehensive income (loss) to interest expense as a result of swap settlements, over the next twelve months.

**Note 10 – Accumulated Other Comprehensive Income**

The following table presents changes in accumulated other comprehensive income by component for the year ended December 31, 2014:

| | Interest Rate Contract |
|---|---|
| Beginning balance | $ 298 |
| Other comprehensive income before reclassifications | (209) |
| Amounts reclassified from accumulated other comprehensive income | 91 |
| Net current period other comprehensive income | (118) |
| Ending balance | $ 180 |

The following table presents reclassifications out of accumulated other comprehensive income for the year ended December 31, 2014:

| Details about Accumulated Other Comprehensive Income Components | Amount Reclassified from Accumulated Other Comprehensive Income | Affected Line Item in the Statement Where Net Income is Presented |
|---|---|---|
| Gain (loss) on cash flow hedges | | |
| Interest rate contracts | $ 152 | Interest expense |
| | (61) | Tax expense |
| Amounts reclassified from accumulated other comprehensive income | $ 91 | Net of tax |

**Note 11 – 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, 2014 and December 31, 2013 was approximately $114.7 million and $116.3 million, respectively, as disclosed in Note 9 to these consolidated financial statements. During 2014 and 2013, dividends of approximately $277,000 and $777,000, respectively, were declared and paid to the City. The dividends paid to the City during 2014 comprised approximately $277,000 of regular quarterly dividends declared and paid; and no special dividend was declared or paid in 2014. The dividends paid to the City during 2013 comprised approximately $277,000 of regular quarterly dividends declared and paid, and a special dividend of $500,000 declared and paid in October 2013, as resolved and authorized by the Board of Directors in their August 23, 2013 meeting.

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, 2014 and 2013, respectively, approximately $3.3 million and $3.1 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 $2.5 million for the year ended December 31, 2014, and approximately $2.4 million for the year ended December 31, 2013.

***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, 2014 was approximately $83.5 million, reduced by the non-regulated credit of approximately $4.6 million.

Aggregate amortization expense for the years ended December 31, 2014 and 2013, totaled approximately $1,835,000 and $2,542,000, respectively. During the year ended December 31, 2012, the amortization of the MARA was calculated based upon the amortization of principal for the Company's unsecured note payable to the City of Nashua (see Note 9). However, during 2013 the Company realized that the amortization of the MARA, as authorized by NHPUC Order 25,292, dated November 23, 2011, was supposed to be calculated based upon the principal repayment schedule of the bonds issued by the City, in support of their acquisition of the Company in January 2012. As such, the Company made a one-time adjustment to "true up" the amortization of the MARA during 2013, and as such, approximately $716,000 of the amortization expense recorded in 2013 relates to amounts that would have been booked in 2012, had the correct basis been applied initially. The amortization amount for 2013 would have been approximately $1,826,000 after giving consideration for this one-time correction.

The following table represents the total estimated amortization of MARA for the five succeeding years:

| (in thousands) | Estimated Amortization Expense |
|---|---|
| 2015 | $ (1,857) |
| 2016 | (1,884) |
| 2017 | (1,917) |
| 2018 | (1,958) |
| 2019 | (2,006) |

**Note 12 – Sale of Conservation Easement**

In July 2013, the Company completed the sale of a conservation easement to the Society for the Protection of New Hampshire Forests, with respect to a portion of its non-regulated land holdings in Merrimack, New Hampshire, as approved by the Board of Directors in their April 26, 2013 meeting. The transaction included gross proceeds for the value of the easement of approximately $991,000, netted by approximately $100,000 of legal, surveying,

and professional fees. The net proceeds of approximately $891,000 from this transaction are included in "Other, Net" on the Consolidated Statements of Income herein.

**Note 13 – Segment Reporting**

The Company is comprised of Pennichuck Corporation and its five wholly-owned subsidiaries, as described in Note 1 to these audited financial statements. For the years ended December 31, 2014 and 2013, and as of those dates, the following financial results were generated by the segments of the Company:

| | 2014 | 2013 |
|---|---|---|
| Operating Revenues: | | |
| Pennichuck Water Works, Inc. | $ 28,193 | $ 27,755 |
| Pennichuck East Utility, Inc. | 6,992 | 6,354 |
| Pittsfield Aqueduct Company, Inc. | 766 | 690 |
| Subtotal Regulated Segment | 35,951 | 34,799 |
| Water Management Services | 2,854 | 2,885 |
| Other | 10 | 10 |
| Total Operating Revenues | $ 38,815 | $ 37,694 |
| Depreciation and Amortization Expense: | | |
| Pennichuck Water Works, Inc. | $ 5,210 | $ 5,687 |
| Pennichuck East Utility, Inc. | 928 | 994 |
| Pittsfield Aqueduct Company, Inc. | 117 | 130 |
| Subtotal Regulated Segment | 6,255 | 6,811 |
| Water Management Services | - | - |
| Other | (107) | (150) |
| Total Depreciation and Amortization Expense | $ 6,148 | $ 6,661 |
| Operating Income: | | |
| Pennichuck Water Works, Inc. | $ 7,410 | $ 6,837 |
| Pennichuck East Utility, Inc. | 1,081 | 438 |
| Pittsfield Aqueduct Company, Inc. | 178 | 16 |
| Subtotal Regulated Segment | 8,669 | 7,291 |
| Water Management Services | 189 | 55 |
| Other | 47 | 92 |
| Total Operating Income | $ 8,905 | $ 7,438 |

| | 2014 | 2013 |
|---|---|---|
| Interest Expense: | | |
| Pennichuck Water Works, Inc. | $ 2,814 | $ 2,775 |
| Pennichuck East Utility, Inc. | 502 | 503 |
| Pittsfield Aqueduct Company, Inc. | 57 | 56 |
| Subtotal Regulated Segment | 3,373 | 3,334 |
| Water Management Services | - | - |
| Other | 6,783 | 6,794 |
| Total Interest Expense | $ 10,156 | $ 10,128 |
| Income Taxes Provision (Benefit): | | |
| Pennichuck Water Works, Inc. | $ 2,474 | $ 2,513 |
| Pennichuck East Utility, Inc. | 309 | 87 |
| Pittsfield Aqueduct Company, Inc. | 60 | 1 |
| Subtotal Regulated Segment | 2,843 | 2,601 |
| Water Management Services | 79 | 21 |
| Other | (2,371) | (3,470) |
| Total Income Taxes Provision (Benefit) | $ 551 | $ (848) |
| Net Income (Loss): | | |
| Pennichuck Water Works, Inc. | $ 2,139 | $ 1,535 |
| Pennichuck East Utility, Inc. | 277 | (138) |
| Pittsfield Aqueduct Company, Inc. | 60 | (42) |
| Subtotal Regulated Segment | 2,476 | 1,355 |
| Water Management Services | 119 | 33 |
| Other | (4,370) | (2,344) |
| Total Net Income (Loss) | $ (1,775) | $ (956) |
| Total Assets: | | |
| Pennichuck Water Works, Inc. | $ 288,349 | $ 231,121 |
| Pennichuck East Utility, Inc. | 42,521 | 41,377 |
| Pittsfield Aqueduct Company, Inc. | 4,418 | 4,526 |
| Subtotal Regulated Segment | 335,288 | 277,024 |
| Water Management Services | 286 | 201 |
| Other | (11,767) | (4,025) |
| Total Net Assets | $ 323,807 | $ 273,200 |

| | 2014 | 2013 |
|---|---|---|
| Total Liabilities: | | |
| Pennichuck Water Works, Inc. | $160,535 | $105,485 |
| Pennichuck East Utility, Inc. | 28,391 | 26,594 |
| Pittsfield Aqueduct Company, Inc. | 2,107 | 2,130 |
| Subtotal Regulated Segment | 191,033 | 134,209 |
| Water Management Services | 56 | 58 |
| Other | 108,128 | 112,173 |
| Total Liabilities | $299,217 | $246,440 |
| Total Long-Term Debt (including current portion): | | |
| Pennichuck Water Works, Inc. | $ 97,895 | $ 50,312 |
| Pennichuck East Utility, Inc. | 11,761 | 10,748 |
| Pittsfield Aqueduct Company, Inc. | - | - |
| Subtotal Regulated Segment | 109,656 | 61,060 |
| Water Management Services | - | - |
| Other | 114,651 | 116,336 |
| Total Long-Term Debt | $224,307 | $177,396 |

**Note 14 – Subsequent Events**

The Company has evaluated the events and transactions that have occurred through March 18, 2015, the date that these financial statements were available for issuance.

On March 4, 2015, Pennichuck East completed a financing transaction with CoBank in the amount of $625,000, for a term of 25 years at an interest rate of 4.9%. This debt is repayable in monthly installments of $3,647, for principal and interest. This financing was completed as a reimbursement for working capital funds used during 2014 for the completion or initiation of capital projects during that year.

Additionally, on March 16, 2015, Pennichuck East completed a financing transaction with the NHDES, under their State Revolving Fund program, in the amount of $510,000. This financing was completed for a specified capital project to be completed in 2015. This obligation will accrue interest at 1% during the construction phase of the project, and then be subject to repayment over a 20-year term, with a rate of interest of 2.72%, with monthly principal and interest payments.

Also, as referenced in Notes 1 and 9 of these audited financial statements, as of January 20, 2015, the entire balance in "Restricted Cash – Bond Refund Escrow" account, which included $23,350,000 of principal due of the "refinanced bonds", as well as approximately $375,000 of accrued interest due on these bonds, was paid out to the holders of those debt instruments.

No other items requiring an adjustment to the financial statement or additional disclosure were noted.