

MIDDLESEX WATER CO
Form 10-Q
August 01, 2017

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the quarterly period ended June 30, 2017

OR

..TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the transition period from _____ to _____

Commission File Number 0-422

MIDDLESEX WATER COMPANY

(Exact name of registrant as specified in its charter)

New Jersey **22-1114430**

(State of incorporation) (IRS employer identification no.)

1500 Ronson Road, Iselin, New Jersey 08830

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

(Address of principal executive offices, including zip code)

(732) 634-1500

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, non-accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

The number of shares outstanding of each of the registrant's classes of common stock, as of July 31, 2017: Common Stock, No Par Value: 16,337,784 shares outstanding.

INDEX

<u>PART I. FINANCIAL INFORMATION</u>	<u>PAGE</u>
<u>Item 1. Financial Statements (Unaudited):</u>	
<u>Condensed Consolidated Statements of Income</u>	1
<u>Condensed Consolidated Balance Sheets</u>	2
<u>Condensed Consolidated Statements of Cash Flows</u>	3
<u>Condensed Consolidated Statements of Capital Stock and Long-Term Debt</u>	4
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	5
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	14
<u>Item 3. Quantitative and Qualitative Disclosures of Market Risk</u>	21
<u>Item 4. Controls and Procedures</u>	22
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	22
<u>Item 1A. Risk Factors</u>	22
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	22
<u>Item 3. Defaults upon Senior Securities</u>	22
<u>Item 4. Mine Safety Disclosures</u>	22
<u>Item 5. Other Information</u>	22
<u>Item 6. Exhibits</u>	23
<u>SIGNATURES</u>	24

Index

MIDDLESEX WATER COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Operating Revenues	\$ 33,014	\$ 32,725	\$ 63,145	\$ 63,304
Operating Expenses:				
Operations and Maintenance	16,651	15,789	32,385	31,617
Depreciation	3,385	3,180	6,693	6,317
Other Taxes	3,415	3,428	6,724	6,740
Total Operating Expenses	23,451	22,397	45,802	44,674
Operating Income	9,563	10,328	17,343	18,630
Other Income (Expense):				
Allowance for Funds Used During Construction	180	119	299	180
Other Income	47	25	53	73
Other Expense	(22)	(7)	(27)	(26)
Total Other Income, net	205	137	325	227
Interest Charges	1,469	1,436	2,472	2,413
Income before Income Taxes	8,299	9,029	15,196	16,444
Income Taxes	2,918	3,110	5,374	5,735
Net Income	5,381	5,919	9,822	10,709
Preferred Stock Dividend Requirements	36	36	72	72
Earnings Applicable to Common Stock	\$ 5,345	\$ 5,883	\$ 9,750	\$ 10,637
Earnings per share of Common Stock:				
Basic	\$ 0.33	\$ 0.36	\$ 0.60	\$ 0.65
Diluted	\$ 0.33	\$ 0.36	\$ 0.59	\$ 0.65

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

Average Number of
Common Shares Outstanding :

Basic	16,332	16,271	16,316	16,252
Diluted	16,488	16,427	16,472	16,408

Cash Dividends Paid per Common Share	\$ 0.2113	\$ 0.1988	\$ 0.4225	\$ 0.3975
--------------------------------------	-----------	-----------	-----------	-----------

See Notes to Condensed Consolidated Financial Statements.

1

Index

MIDDLESEX WATER COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands)

		June 30, 2017	December 31, 2016
ASSETS			
UTILITY PLANT:	Water Production	\$149,068	\$146,914
	Transmission and Distribution	443,128	430,880
	General	67,692	63,514
	Construction Work in Progress	13,828	12,196
	TOTAL	673,716	653,504
	Less Accumulated Depreciation	140,435	135,728
	UTILITY PLANT - NET	533,281	517,776
CURRENT ASSETS:	Cash and Cash Equivalents	3,689	3,879
	Accounts Receivable, net	9,953	10,129
	Unbilled Revenues	8,284	6,590
	Materials and Supplies (at average cost)	4,881	4,094
	Prepayments	2,912	2,024
	TOTAL CURRENT ASSETS	29,719	26,716
AND OTHER ASSETS:	Preliminary Survey and Investigation Charges	3,142	2,365
	Regulatory Assets	60,474	60,894
	Operations Contracts, Developer and Other Receivables	789	1,139
	Restricted Cash	439	439
	Non-utility Assets - Net	9,252	9,131
	Federal Income Tax Receivable	1,408	1,408
	Other	226	293
	TOTAL DEFERRED CHARGES AND OTHER ASSETS	75,730	75,669
	TOTAL ASSETS	\$638,730	\$620,161
CAPITALIZATION AND LIABILITIES			
CAPITALIZATION:	Common Stock, No Par Value	\$154,075	\$153,045
	Retained Earnings	68,249	65,392
	TOTAL COMMON EQUITY	222,324	218,437
	Preferred Stock	2,435	2,436
	Long-term Debt	136,429	134,538
	TOTAL CAPITALIZATION	361,188	355,411
CURRENT	Current Portion of Long-term Debt	6,164	6,159

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

LIABILITIES:	Notes Payable	17,000	12,000
	Accounts Payable	15,045	12,343
	Accrued Taxes	13,137	12,385
	Accrued Interest	1,078	1,084
	Unearned Revenues and Advanced Service Fees	967	923
	Other	2,026	2,162
	TOTAL CURRENT LIABILITIES	55,417	47,056
COMMITMENTS AND CONTINGENT LIABILITIES (Note 7)			
DEFERRED CREDITS	Customer Advances for Construction	20,862	20,846
AND OTHER LIABILITIES:	Accumulated Deferred Investment Tax Credits	714	753
	Accumulated Deferred Income Taxes	76,312	72,072
	Employee Benefit Plans	34,651	36,139
	Regulatory Liability - Cost of Utility Plant Removal	11,711	11,337
	Other	1,378	1,443
	TOTAL DEFERRED CREDITS AND OTHER LIABILITIES	145,628	142,590
CONTRIBUTIONS IN AID OF CONSTRUCTION		76,497	75,104
	TOTAL CAPITALIZATION AND LIABILITIES	\$638,730	\$620,161

See Notes to Condensed Consolidated Financial Statements.

Index

MIDDLESEX WATER COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six Months Ended June 30,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$9,822	\$ 10,709
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	6,887	6,800
Provision for Deferred Income Taxes and Investment Tax Credits	4,395	3,321
Equity Portion of Allowance for Funds Used During Construction (AFUDC)	(205)	(118)
Cash Surrender Value of Life Insurance	(114)	(44)
Stock Compensation Expense	437	468
Changes in Assets and Liabilities:		
Accounts Receivable	176	(848)
Unbilled Revenues	(1,694)	(1,908)
Materials and Supplies	(787)	(2,132)
Prepayments	(888)	(1,207)
Accounts Payable	2,702	3,064
Accrued Taxes	752	313
Accrued Interest	(6)	(13)
Employee Benefit Plans	(640)	(580)
Unearned Revenue & Advanced Service Fees	44	19
Other Assets and Liabilities	(710)	(1,099)
NET CASH PROVIDED BY OPERATING ACTIVITIES	20,171	16,745
CASH FLOWS FROM INVESTING ACTIVITIES:		
Utility Plant Expenditures, Including AFUDC of \$94 in 2017, \$62 in 2016	(21,165)	(20,111)
NET CASH USED IN INVESTING ACTIVITIES	(21,165)	(20,111)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Redemption of Long-term Debt	(2,115)	(2,136)
Proceeds from Issuance of Long-term Debt	4,047	861
Net Short-term Bank Borrowings	5,000	7,500
Deferred Debt Issuance Expense	(33)	(15)
Proceeds from Issuance of Common Stock	592	830
Payment of Common Dividends	(6,893)	(6,454)
Payment of Preferred Dividends	(72)	(72)

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

Construction Advances and Contributions-Net	278	612
NET CASH PROVIDED BY FINANCING ACTIVITIES	804	1,126
NET CHANGES IN CASH AND CASH EQUIVALENTS	(190)	(2,240)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	3,879	3,469
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$3,689	\$1,229

SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITY:

Utility Plant received as Construction Advances and Contributions	\$1,131	\$1,395
Long-term Debt Deobligation	\$—	\$534

SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:

Cash Paid During the Year for:		
Interest	\$2,594	\$2,538
Interest Capitalized	\$94	\$62
Income Taxes	\$714	\$3,131

See Notes to Condensed Consolidated Financial Statements.

Index

MIDDLESEX WATER COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CAPITAL STOCK

AND LONG-TERM DEBT

(Unaudited)

(In thousands)

	June 30, 2017	December 31, 2016
Common Stock, No Par Value		
Shares Authorized - 40,000		
Shares Outstanding - 2017 - 16,336; 2016 - 16,296	\$154,075	\$ 153,045
Retained Earnings	68,249	65,392
TOTAL COMMON EQUITY	\$222,324	\$ 218,437
Cumulative Preferred Stock, No Par Value:		
Shares Authorized - 126		
Shares Outstanding - 24		
Convertible:		
Shares Outstanding, \$7.00 Series - 10	\$1,007	\$ 1,007
Shares Outstanding, \$8.00 Series - 3	349	349
Nonredeemable:		
Shares Outstanding, \$7.00 Series - 1	79	80
Shares Outstanding, \$4.75 Series - 10	1,000	1,000
TOTAL PREFERRED STOCK	\$2,435	\$ 2,436
Long-term Debt:		
8.05%, Amortizing Secured Note, due December 20, 2021	\$1,300	\$ 1,415
6.25%, Amortizing Secured Note, due May 19, 2028	4,585	4,795
6.44%, Amortizing Secured Note, due August 25, 2030	3,687	3,827
6.46%, Amortizing Secured Note, due September 19, 2031	3,967	4,107
4.22%, State Revolving Trust Note, due December 31, 2022	304	329
3.60%, State Revolving Trust Note, due May 1, 2025	1,958	2,062
3.30% State Revolving Trust Note, due March 1, 2026	411	431
3.49%, State Revolving Trust Note, due January 25, 2027	446	465
4.03%, State Revolving Trust Note, due December 1, 2026	578	603
4.00% to 5.00%, State Revolving Trust Bond, due August 1, 2021	213	213
0.00%, State Revolving Fund Bond, due August 1, 2021	162	166
3.64%, State Revolving Trust Note, due July 1, 2028	266	276
3.64%, State Revolving Trust Note, due January 1, 2028	87	91
3.45%, State Revolving Trust Note, due August 1, 2031	989	1,015
6.59%, Amortizing Secured Note, due April 20, 2029	4,127	4,302
7.05%, Amortizing Secured Note, due January 20, 2030	3,146	3,271

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

5.69%, Amortizing Secured Note, due January 20, 2030	6,453	6,709
4.45%, Amortizing Secured Note, due April 20, 2040	10,047	10,267
4.47%, Amortizing Secured Note, due April 20, 2040	3,728	3,809
3.75%, State Revolving Trust Note, due July 1, 2031	2,133	2,191
2.00%, State Revolving Trust Note, due February 1, 2036	1,115	1,115
3.75%, State Revolving Trust Note, due November 30, 2030	1,123	1,154
0.00% Construction Loans	11,517	7,470
First Mortgage Bonds:		
0.00%, Series X, due August 1, 2018	105	107
4.25% to 4.63%, Series Y, due August 1, 2018	123	122
0.00%, Series Z, due August 1, 2019	329	336
5.25% to 5.75%, Series AA, due August 1, 2019	440	440
0.00%, Series BB, due August 1, 2021	590	603
4.00% to 5.00%, Series CC, due August 1, 2021	779	779
0.00%, Series EE, due August 1, 2023	2,641	2,713
3.00% to 5.50%, Series FF, due August 1, 2024	3,690	3,690
0.00%, Series GG, due August 1, 2026	887	903
4.00% to 5.00%, Series HH, due August 1, 2026	960	960
0.00%, Series II, due August 1, 2024	683	700
3.40% to 5.00%, Series JJ, due August 1, 2027	824	824
0.00%, Series KK, due August 1, 2028	1,058	1,078
5.00% to 5.50%, Series LL, due August 1, 2028	1,175	1,175
0.00%, Series MM, due August 1, 2030	1,304	1,337
3.00% to 4.375%, Series NN, due August 1, 2030	1,590	1,590
0.00%, Series OO, due August 1, 2031	2,207	2,258
2.00% to 5.00%, Series PP, due August 1, 2031	780	780
5.00%, Series QQ, due October 1, 2023	9,915	9,915
3.80%, Series RR, due October 1, 2038	22,500	22,500
4.25%, Series SS, due October 1, 2047	23,000	23,000
0.00%, Series TT, due August 1, 2032	2,358	2,408
3.00% to 3.25%, Series UU, due August 1, 2032	890	890
0.00%, Series VV, due August 1, 2033	2,386	2,433
3.00% to 5.00%, Series WW, due August 1, 2033	865	865
SUBTOTAL LONG-TERM DEBT	144,421	142,489
Add: Premium on Issuance of Long-term Debt	1,388	1,495
Less: Unamortized Debt Expense	(3,216)	(3,287)
Less: Current Portion of Long-term Debt	(6,164)	(6,159)
TOTAL LONG-TERM DEBT	\$136,429	\$ 134,538

See Notes to Condensed Consolidated Financial Statements.

Index

MIDDLESEX WATER COMPANY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Basis of Presentation and Recent Developments

Middlesex Water Company (Middlesex or the Company) is the parent company and sole shareholder of Tidewater Utilities, Inc. (Tidewater), Tidewater Environmental Services, Inc. (TESI), Pinelands Water Company (Pinelands Water) and Pinelands Wastewater Company (Pinelands Wastewater) (collectively, Pinelands), Utility Service Affiliates, Inc. (USA), Utility Service Affiliates (Perth Amboy) Inc. (USA-PA), and Twin Lakes Utilities, Inc. (Twin Lakes). Southern Shores Water Company, LLC (Southern Shores) and White Marsh Environmental Systems, Inc. (White Marsh) are wholly-owned subsidiaries of Tidewater. The financial statements for Middlesex and its wholly-owned subsidiaries (the Company) are reported on a consolidated basis. All significant intercompany accounts and transactions have been eliminated.

The consolidated notes within the 2016 Annual Report on Form 10-K (the 2016 Form 10-K) are applicable to these financial statements and, in the opinion of the Company, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary (including normal recurring accruals) to present fairly the financial position as of June 30, 2017, the results of operations for the three and six month periods ended June 30, 2017 and 2016 and cash flows for the six month periods ended June 30, 2017 and 2016. Information included in the Condensed Consolidated Balance Sheet as of December 31, 2016, has been derived from the Company's audited financial statements for the year ended December 31, 2016 included in the 2016 Form 10-K.

Recent Accounting Guidance

Inventory - In July 2015, the Financial Accounting Standards Board (FASB) issued guidance on simplifying the measurement of inventory. The new guidance replaces the current lower of cost or market test with a lower of cost or net realizable value test when cost is determined on a first-in, first-out or average cost basis. The guidance was effective January 1, 2017 and did not have a material impact on the Company's financial statements.

Accounting for Share-Based Payments - In March 2016, the FASB issued guidance which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The guidance was effective January 1, 2017 and did not have a material impact on the Company's financial statements.

Revenue Recognition - In May 2014, the FASB issued guidance related to revenue from contracts with customers. The update replaces most of the existing guidance with a single set of principles for recognizing revenue from contracts with customers. The FASB has deferred the effective date of these new revenue recognition standards by one year to January 1, 2018. The Company is currently analyzing the impact this standard will have on our financial statements and has begun creating an inventory of its contracts with customers, which consist primarily of regulated municipal water sale contracts and non-regulated operation and maintenance contracts for water and wastewater systems. Based on the Company's initial interpretation of the guidance, this update is not expected to have an impact on the Company's regulated municipal water sale contracts. The impact on the Company's non-regulated operation and maintenance contracts, if any, is not expected to be material. The Company's non-regulated segment contributed approximately 12% and 7% of total revenues and net income, respectively, for the six months ended June 30, 2017 and approximately 11% and 2% of total revenues and net income, respectively, for the year ended December 31, 2016. These assessments are preliminary and subject to change pending the Company's completion of its review of the guidance and its impact on the Company's contracts with customers.

Index

Recognition and Measurement of Financial Assets and Financial Liabilities - In January 2016, the FASB issued guidance which (i) requires all investments in equity securities, including other ownership interests such as partnerships, unincorporated joint ventures and limited liability companies, to be carried at fair value through net income, (ii) requires an incremental recognition and disclosure requirement related to the presentation of fair value changes of financial liabilities for which the fair value option has been elected, (iii) amends several disclosure requirements, including the methods and significant assumptions used to estimate fair value or a description of the changes in the methods and assumptions used to estimate fair value, and (iv) requires disclosure of the fair value of financial assets and liabilities measured at amortized cost at the amount that would be received to sell the asset or paid to transfer the liability. The guidance is effective for fiscal years beginning after December 15, 2017 with early adoption permitted. The guidance is required to be applied retrospectively with a cumulative effect adjustment to retained earnings for initial application of the guidance at the date of adoption (modified retrospective method). The Company is currently assessing the impact of this standard on its consolidated financial statements and footnote disclosures, but does not expect that the adoption of this guidance to have a material impact on the Company's financial statements.

Leases - In February 2016, the FASB issued guidance related to leases which will require lessees to recognize a lease liability (a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis) a right-of-use asset (an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term). The guidance is effective for fiscal years beginning after December 15, 2018 with early adoption permitted. The Company is currently assessing the impact of this standard on its consolidated financial statements and footnote disclosures, but does not expect that the adoption of this guidance to have a material impact on the Company's financial statements.

Statement of Cash Flows - In August 2016, the FASB issued guidance which amends the previous guidance on the classification of certain cash receipts and payments in the statement of cash flows. The primary purpose of this guidance is to reduce the diversity in practice that has resulted from the lack of consistent principles on this topic. The guidance is effective January 1, 2018 with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company's financial statements.

Restricted Cash - In November 2016, the FASB issued guidance related to the classification and presentation of restricted cash in the statement of cash flows, which requires entities to a) include restricted cash balances in its cash and cash-equivalent balances in the statement of cash flows and b) include a reconciliation of cash and cash-equivalents per the statement of financial position as compared to the statement of cash flows. Changes in restricted cash and restricted cash equivalents that result from transfers between cash, cash equivalents, and restricted cash and restricted cash equivalents will not be presented as cash flow activities in the statement of cash flows. In addition, an entity with a material balance of amounts described as restricted cash and restricted cash equivalents must disclose information about the nature of the restrictions. The guidance is effective January 1, 2018 with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company's financial statements.

Employee Benefit Plans-Net Periodic Benefit Cost – In March 2017, the FASB issued guidance which requires entities to (1) disaggregate the current-service-cost component from the other components of net benefit cost and present it with other current compensation costs for related employees in the income statement and (2) present the other components elsewhere in the income statement and outside of income from operations if that subtotal is presented. In addition, the ASU requires entities to disclose the income statement lines that contain the other components if they are not presented on appropriately described separate lines. The guidance is effective January 1, 2018. The Company is currently assessing the impact of this standard on its consolidated financial statements and footnote disclosures, but does not expect that the adoption of this guidance to have a material impact on the Company's financial statements.

Index

There are no other new adopted or proposed accounting guidance that the Company is aware of that could have a material impact on the Company's financial statements.

Note 2 – Rate and Regulatory Matters

Middlesex-In May 2017, Middlesex filed a petition with the New Jersey Board of Public Utilities (the NJBPU) seeking approval to reset its purchased water adjustment clause (PWAC) tariff rate. A PWAC is an optional rate mechanism that allows for the recovery of increased purchased water costs in between base rate case filings with the PWAC reset to zero once those increased costs are included in base rates. A PWAC is subject to an annual true-up. The current PWAC rate became effective November 1, 2016. The current filing includes the true-up and a request to recover additional annual costs of \$1.2 million for the purchase of untreated water from the New Jersey Water Supply Authority (NJWSA). The NJWSA increased the rate it charges its subscribers on July 1, 2017. The Company expects that the NJBPU will approve the PWAC rate reset by October 2017 with an effective date of November 1, 2017.

Tidewater - Effective July 1, 2017, Tidewater reset its Delaware Public Service Commission-approved Distribution System Improvement Charge (DSIC) rate, which is expected to generate \$0.4 million of annual revenues. A DSIC is a rate-mechanism that allows water utilities to recover investments in, and generate a return on, qualifying capital improvements to their water distribution system made between base rate proceedings.

Note 3 – Capitalization

Common Stock

During the six months ended June 30, 2017 and 2016, there were 15,954 common shares (approximately \$0.6 million) and 26,434 common shares (approximately \$0.8 million), respectively, issued under the Middlesex Water Company Investment Plan.

Long-term Debt

In January 2017, the NJBPU approved Middlesex's request to borrow up to \$37.0 million under the New Jersey State Revolving Fund (SRF) program to fund the construction of a large-diameter transmission pipeline from the Carl J. Olsen water treatment plant and interconnect with our distribution system. Middlesex currently expects to close on the SRF construction loan in the first quarter of 2018 with funding requisitions occurring primarily throughout 2018 and 2019.

In January 2017, the NJBPU approved Middlesex's request to borrow up to \$10.0 million under the New Jersey SRF program to fund the 2017 RENEW Program, which is an ongoing initiative to eliminate all unlined water distribution mains in the Middlesex system. Middlesex expects to close on the SRF construction loan in August 2017 with funding requisitions occurring primarily throughout the remainder of 2017.

Middlesex closed on a \$2.3 million NJBPU approved SRF construction loan in May 2017. The proceeds will be used to fund the upgrade of a booster station at one of its well fields. Funding requisitions are expected to occur through May 2018.

Fair Value of Financial Instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosure for financial instruments for which it is practicable to estimate that value. The carrying amounts reflected in the condensed consolidated balance sheets for cash and cash equivalents, trade receivables, accounts payable and notes payable approximate their respective fair values due to the short-term maturities of these instruments. The fair value of First Mortgage and SRF Bonds (collectively, the Bonds) issued by Middlesex is based on quoted market prices for similar issues. Under the fair value hierarchy, the fair value of cash and cash equivalents is

Index

classified as a Level 1 measurement and the fair value of notes payable and the Bonds in the table below are classified as Level 2 measurements. The carrying amount and fair value of the Bonds were as follows:

	June 30, 2017		December 31, 2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Bonds	\$ 82,454	\$ 84,552	\$82,786	\$84,821

For other long-term debt for which there was no quoted market price and there is not an active trading market, it was not practicable to estimate their fair value (for details, including carrying value, interest rate and due date on these series of long-term debt, please refer to those series noted as “Amortizing Secured Note”, “State Revolving Trust Note” and “Construction Loans” on the Condensed Consolidated Statements of Capital Stock and Long-Term Debt). The carrying amount of these instruments was \$62.0 million and \$59.7 million at June 30, 2017 and December 31, 2016, respectively. Customer advances for construction have carrying amounts of \$20.9 million and \$20.8 million at June 30, 2017 and December 31, 2016, respectively. Their relative fair values cannot be accurately estimated since future refund payments depend on several variables, including new customer connections, customer consumption levels and future rate increases.

Note 4 – Earnings Per Share

Basic earnings per share (EPS) are computed on the basis of the weighted average number of shares outstanding during the period presented. Diluted EPS assumes the conversion of both the Convertible Preferred Stock \$7.00 Series and the Convertible Preferred Stock \$8.00 Series.

	(In Thousands Except per Share Amounts)			
	Three Months Ended June 30, 2017		2016	
	Income	Shares	Income	Shares
Basic:				
Net Income	\$5,381	16,332	\$5,919	16,271
Preferred Dividend	(36)		(36)	
Earnings Applicable to Common Stock	\$5,345	16,332	\$5,883	16,271
Basic EPS	\$0.33		\$0.36	

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

Diluted:

Earnings Applicable to Common Stock	\$5,345	16,332	\$5,883	16,271
\$7.00 Series Preferred Dividend	17	115	17	115
\$8.00 Series Preferred Dividend	6	41	6	41
Adjusted Earnings Applicable to Common Stock	\$5,368	16,488	\$5,906	16,427
Diluted EPS	\$0.33		\$0.36	

Index

	(In Thousands Except per Share Amounts)			
	Six Months Ended June 30,			
	2017		2016	
	Income	Shares	Income	Shares
Basic:				
Net Income	\$9,822	16,316	\$10,709	16,252
Preferred Dividend	(72)		(72)	
Earnings Applicable to Common Stock	\$9,750	16,316	\$10,637	16,252
Basic EPS	\$0.60		\$0.65	
Diluted:				
Earnings Applicable to Common Stock	\$9,750	16,316	\$10,637	16,252
\$7.00 Series Preferred Dividend	34	115	34	115
\$8.00 Series Preferred Dividend	12	41	12	41
Adjusted Earnings Applicable to Common Stock	\$9,796	16,472	\$10,683	16,408
Diluted EPS	\$0.59		\$0.65	

Note 5 – Business Segment Data

The Company has identified two reportable segments. One is the regulated business of collecting, treating and distributing water on a retail and wholesale basis to residential, commercial, industrial and fire protection customers in parts of New Jersey, Delaware and Pennsylvania. This segment also includes regulated wastewater systems in New Jersey and Delaware. The Company is subject to regulations as to its rates, services and other matters by New Jersey, Delaware and Pennsylvania with respect to utility services within these states. The other segment is primarily comprised of non-regulated contract services for the operation and maintenance of municipal and private water and wastewater systems in New Jersey and Delaware. Inter-segment transactions relating to operational costs are treated as pass-through expenses. Finance charges on inter-segment loan activities are based on interest rates that are below what would normally be charged by a third party lender.

Index

	(In Thousands)			
	Three Months Ended		Six Months Ended	
	June 30, 2017	2016	June 30, 2017	2016
Operations by Segments:				
Revenues:				
Regulated	\$29,278	\$28,859	\$55,771	\$55,808
Non – Regulated	3,863	4,002	7,613	7,736
Inter-segment Elimination	(127)	(136)	(239)	(240)
Consolidated Revenues	\$33,014	\$32,725	\$63,145	\$63,304
Operating Income:				
Regulated	\$8,877	\$9,694	\$16,097	\$17,426
Non – Regulated	686	634	1,246	1,204
Consolidated Operating Income	\$9,563	\$10,328	\$17,343	\$18,630
Net Income:				
Regulated	\$4,972	\$5,583	\$9,111	\$10,073
Non – Regulated	409	336	711	636
Consolidated Net Income	\$5,381	\$5,919	\$9,822	\$10,709
Capital Expenditures:				
Regulated	\$11,588	\$13,290	\$21,160	\$19,950
Non – Regulated	—	149	5	161
Total Capital Expenditures	\$11,588	\$13,439	\$21,165	\$20,111

	As of June 30, 2017	As of December 31, 2016
Assets:		
Regulated	\$642,726	\$619,915
Non – Regulated	6,681	6,245
Inter-segment Elimination	(10,677)	(5,999)
Consolidated Assets	\$638,730	\$620,161

Note 6 – Short-term Borrowings

As of June 30, 2017, the Company has established lines of credit aggregating \$60.0 million. At June 30, 2017, the outstanding borrowings under these credit lines were \$17.0 million at a weighted average interest rate of 2.22%.

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

The weighted average daily amounts of borrowings outstanding under the Company's credit lines and the weighted average interest rates on those amounts were as follows:

	(In Thousands)			
	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Average Daily Amounts Outstanding	\$15,582	\$3,769	\$14,221	\$3,368
Weighted Average Interest Rates	2.08%	1.52%	1.95%	1.48%

Index

The maturity dates for the \$17.0 million outstanding as of June 30, 2017 are all in July 2017 and are extendable at the discretion of the Company.

Interest rates for short-term borrowings under the lines of credit are below the prime rate with no requirement for compensating balances.

Note 7 – Commitments and Contingent Liabilities

Water Supply

Middlesex has an agreement with the New Jersey Water Supply Authority (NJWSA) for the purchase of untreated water through November 30, 2023, which provides for an average purchase of 27.0 million gallons a day (mgd). Pricing is set annually by the NJWSA through a public rate making process. The agreement has provisions for additional pricing in the event Middlesex overdrafts or exceeds certain monthly and annual thresholds.

Middlesex also has an agreement with a non-affiliated regulated water utility for the purchase of treated water. This agreement, which expires February 27, 2021, provides for the minimum purchase of 3.0 mgd of treated water with provisions for additional purchases.

Tidewater contracts with the City of Dover, Delaware to purchase 15.0 million gallons of treated water annually.

Purchased water costs are shown below:

	(In Thousands)			
	Three Months Ended		Six Months Ended	
	June 30, 2017	2016	June 30, 2017	2016
Treated	\$795	\$754	\$1,574	\$1,555
Untreated	573	570	1,232	1,236
Total Costs	\$1,368	\$1,324	\$2,806	\$2,791

Contract Operations - USA-PA operates the City of Perth Amboy, New Jersey's (Perth Amboy) water and wastewater systems under a 20-year agreement, which expires in 2018. In connection with the agreement with Perth Amboy, USA-PA entered into a concurrent subcontract with a wastewater operating company for the operation and maintenance of the Perth Amboy wastewater collection system. The subcontract provides for the sharing of certain fixed and variable fees and operating expenses.

Guarantees - As part of an agreement with the County of Monmouth, New Jersey (County), Middlesex serves as guarantor of the performance of Applied Water Management, Inc. (AWM), an unaffiliated wastewater treatment contractor, to operate a County-owned leachate pretreatment facility at the Monmouth County Reclamation Center in Tinton Falls, New Jersey. The performance guaranty is effective through 2028 unless another guarantor, acceptable to the County, replaces Middlesex before such date. Under agreements with AWM and Natural Systems Utilities, LLC (NSU), the parent company of AWM, Middlesex earns a fee for providing the performance guaranty. In addition, Middlesex may provide operational support to the facility, as needed, and AWM and NSU, serving as guarantor to Middlesex with respect to the performance of AWM, agree to indemnify Middlesex against any claims that may arise under the Middlesex guaranty to the County.

If requested to perform under the guaranty to the County and, if AWM and NSU, as guarantor to Middlesex, do not fulfill their obligations to indemnify Middlesex against any claims that may arise under the Middlesex guaranty to the County, Middlesex would be required to fulfill the remaining operational commitment of AWM. As of both June 30, 2017 and December 31, 2016, the liability recognized in Other Non-Current Liabilities on the balance sheet for the guaranty is approximately \$0.1 million.

Index

Construction

The Company has budgeted approximately \$60 million for its construction program in 2017. The actual timing and amount of capital expenditures is dependent on project scheduling and refinement of engineering estimates for certain projects.

Litigation

The Company is a defendant in lawsuits in the normal course of business. We believe the resolution of pending claims and legal proceedings will not have a material adverse effect on the Company's consolidated financial statements.

Change in Control Agreements

The Company has Change in Control Agreements with certain of its officers that provide compensation and benefits in the event of termination of employment in connection with a change in control of the Company.

Note 8 – Employee Benefit Plans

Pension Benefits

The Company's Pension Plan covers all active employees hired prior to April 1, 2007. Employees hired after March 31, 2007 are not eligible to participate in this plan, but do participate in a defined contribution plan that provides an annual contribution at the discretion of the Company, based upon a percentage of the participants' compensation. In order to be eligible for a contribution, the participant must be employed by the Company on December 31st of the year to which the contribution relates. For each of the three and six month periods ended June 30, 2017 and 2016, the Company made Pension Plan cash contributions of \$1.0 million and \$1.5 million, respectively. The Company expects to make Pension Plan cash contributions of approximately \$1.8 million over the remainder of the current year. The Company also maintains an unfunded supplemental retirement benefit plan for certain active and retired Company officers and currently pays \$0.3 million in annual benefits to the retired participants.

Other Postretirement Benefits

The Company's retirement plan other than pensions (Other Benefits Plan) covers substantially all of its current retired employees. Employees hired after March 31, 2007 are not eligible to participate in this plan. Coverage includes healthcare and life insurance. For each of the three and six month periods ended June 30, 2017 and 2016, the Company made Other Benefits Plan cash contributions of \$0.2 million and \$0.5 million, respectively. The Company expects to make Other Benefits Plan cash contributions of approximately \$1.2 million over the remainder of the current year.

Index

The following tables set forth information relating to the Company's periodic costs for its employee retirement benefit plans:

	(In Thousands)			
	Pension Benefits		Other Benefits	
	Three Months Ended June 30,			
	2017	2016	2017	2016
Service Cost	\$600	\$577	\$272	\$275
Interest Cost	786	761	491	488
Expected Return on Assets	(1,122)	(1,004)	(601)	(558)
Amortization of Unrecognized Losses	391	357	445	443
Amortization of Unrecognized Prior Service Cost (Credit)	—	—	(432)	(432)
Net Periodic Benefit Cost	\$655	\$691	\$175	\$216

	(In Thousands)			
	Pension Benefits		Other Benefits	
	Six Months Ended June 30,			
	2017	2016	2017	2016
Service Cost	\$1,200	\$1,154	\$544	\$550
Interest Cost	1,572	1,523	982	976
Expected Return on Assets	(2,245)	(2,007)	(1,203)	(1,116)
Amortization of Unrecognized Losses	783	713	890	886
Amortization of Unrecognized Prior Service Cost (Credit)	—	—	(864)	(864)
Net Periodic Benefit Cost	\$1,310	\$1,383	\$349	\$432

Note 9 – Income Taxes

As part of its 2014 Federal income tax return, the Company adopted the final Internal Revenue Service (IRS) regulations pertaining to the tax deductibility of costs that qualify as repairs on tangible property. The adoption resulted in a net reduction of \$17.6 million in taxes previously remitted to the IRS, for which the Company has already sought and received refunds pertaining to tax years 2012 through 2014 in accordance with IRS regulations. Subsequently, the Company's 2014 federal income tax return was selected for examination by the IRS. It is unknown at this time whether the results of this examination will result in any changes to the filed Federal income tax return.

Index

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements of Middlesex Water Company (Middlesex or the Company) included elsewhere herein and with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

Forward-Looking Statements

Certain statements contained in this periodic report and in the documents incorporated by reference constitute "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. The Company intends that these statements be covered by the safe harbors created under those laws. They include, but are not limited to statements as to:

- expected financial condition, performance, prospects and earnings of the Company;
- strategic plans for growth;
- the amount and timing of rate increases and other regulatory matters, including the recovery of certain costs recorded as regulatory assets;
- the Company's expected liquidity needs during the upcoming fiscal year and beyond and the sources and availability of funds to meet its liquidity needs;
- expected customer rates, consumption volumes, service fees, revenues, margins, expenses and operating results;
- financial projections;
- the expected amount of cash contributions to fund the Company's retirement benefit plans, anticipated discount rates and rates of return on retirement benefit plan assets;
- the ability of the Company to pay dividends;
- the Company's compliance with environmental laws and regulations and estimations of the materiality of any related costs;
- the safety and reliability of the Company's equipment, facilities and operations;
- the Company's plans to renew municipal franchises and consents in the territories it serves;
- trends; and
- the availability and quality of our water supply.

These forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from future results expressed or implied by the forward-looking statements. Important factors that could cause actual results to differ materially from anticipated results and outcomes include, but are not limited to:

- effects of general economic conditions;
- increases in competition for growth in non-franchised markets to be potentially served by the Company;
- ability of the Company to adequately control selected operating expenses which are necessary to maintain safe and proper utility services, and which may be beyond the Company's control;
- availability of adequate supplies of water;
- actions taken by government regulators, including decisions on rate increase requests;
- new or modified water quality standards;
- weather variations and other natural phenomena impacting utility operations;
- financial and operating risks associated with acquisitions and/or privatizations;
- acts of war or terrorism;
- changes in the pace of housing development;

- availability and cost of capital resources; and
- other factors discussed elsewhere in this quarterly report.

Many of these factors are beyond the Company's ability to control or predict. Given these uncertainties, readers are cautioned not to place undue reliance on any forward-looking statements, which only speak to the Company's understanding as of the date of this report. The Company does not undertake any obligation to release publicly any revisions to these forward-looking statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events, except as may be required under applicable securities laws.

Index

For an additional discussion of factors that may affect the Company's business and results of operations, see Item 1A. - Risk Factors in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

Overview

Middlesex Water Company (Middlesex) has operated as a water utility in New Jersey since 1897, in Delaware through our wholly-owned subsidiary, Tidewater Utilities, Inc. (Tidewater), since 1992 and in Pennsylvania through our wholly-owned subsidiary, Twin Lakes Utilities, Inc. (Twin Lakes), since 2009. We are in the business of collecting, treating and distributing water for domestic, commercial, municipal, industrial and fire protection purposes. We also operate two New Jersey municipal water and wastewater systems under contract and provide regulated wastewater services in New Jersey and Delaware through our subsidiaries. We are regulated as to rates charged to customers for water and wastewater services, as to the quality of water service we provide and as to certain other matters in New Jersey, Delaware and Pennsylvania. Only our Utility Service Affiliates, Inc. (USA), Utility Service Affiliates (Perth Amboy), Inc. (USA-PA) and White Marsh Environmental Services, Inc. (White Marsh) subsidiaries are not regulated utilities.

Our New Jersey water utility system (the Middlesex System) provides water services to approximately 61,000 retail customers, primarily in central New Jersey. The Middlesex System also provides water service under contract to municipalities in central New Jersey with a total population of approximately 219,000. Our Bayview subsidiary provides water services in Downe Township, New Jersey. Our other New Jersey subsidiaries, Pinelands Water Company (Pinelands Water) and Pinelands Wastewater Company (Pinelands Wastewater) (collectively, Pinelands), provide water and wastewater services to residents in Southampton Township, New Jersey.

In partnership with our subsidiary, USA-PA, we operate the water supply system and wastewater system for the City of Perth Amboy, New Jersey.

USA operates the Borough of Avalon, New Jersey's (Avalon) water utility, sewer utility and storm water system under a ten-year operations and maintenance contract expiring in 2022. In addition to performing day to day operations, USA is responsible for billing, collections, customer service, emergency responses and management of capital projects funded by Avalon. Under a marketing agreement with HomeServe USA (HomeServe), USA offers residential customers in New Jersey and Delaware a menu of water and wastewater related home maintenance programs. HomeServe is a leading national provider of such home maintenance service programs. USA receives a service fee for the billing, cash collection and other administrative matters associated with HomeServe's service contracts. The agreement expires in 2021. USA also provides unregulated water and wastewater services under contract with several New Jersey municipalities.

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

Our Delaware subsidiaries, Tidewater and Southern Shores Water Company, LLC, provide water services to approximately 43,000 retail customers in New Castle, Kent and Sussex Counties, Delaware. Tidewater's subsidiary, White Marsh, services approximately 4,000 customers in Kent and Sussex Counties through various operations and maintenance contracts.

Our Tidewater Environmental Services, Inc. subsidiary provides wastewater services to approximately 3,400 residential retail customers in Sussex County, Delaware.

Our Pennsylvania subsidiary, Twin Lakes, provides water services to approximately 120 retail customers in the Township of Shohola, Pike County, Pennsylvania.

Index

The majority of our revenue is generated from retail and contract water services to customers in our service areas. We record water service revenue as such service is rendered and include estimates for amounts unbilled at the end of the period for services provided after the last billing cycle. Fixed service charges are billed in advance by our subsidiary, Tidewater, and are recognized in revenue as the service is provided.

Our ability to increase operating income and net income is based significantly on four factors: weather, adequate and timely rate relief, effective cost management, and customer growth. These factors are evident in the discussions below which compare our results of operations with the prior period.

Recent Developments

Capital Construction Program - The Company's multi-year capital construction program involves numerous projects designed to upgrade and replace infrastructure as well as enhance the integrity of system assets to better serve the current and future generations of water users. The Company plans to invest approximately \$149 million through 2018 in connection with this plan for projects including:

- Construction of a 4.6 mile water transmission pipeline to provide critical resiliency and redundancy capability to the Company's water transmission system in New Jersey;

- Replacement of five miles of water mains including service lines, valves, fire hydrants and meters in the Borough of South Plainfield, New Jersey;

 - Enhanced treatment process at the Company's largest water plant in Edison, New Jersey, to mitigate the formation of disinfection by-products that can develop naturally during treatment;

 - Additional elevated storage tanks to supplement water supply during emergencies and peak usage periods;

 - Upgrades to water interconnections with neighboring utilities for greater resiliency and emergency response;

- Relocation of water meters from inside customers' premises to exterior meter pits to allow quicker access by crews in emergencies, enhanced customer safety and convenience and reduced unmetered water; and

 - Additional standby emergency power generation.

Middlesex- In May 2017, Middlesex filed a petition with the New Jersey Board of Public Utilities (the NJBPU) seeking approval to reset its purchased water adjustment clause (PWAC) tariff rate. A PWAC is an optional rate mechanism that allows for the recovery of increased purchased water costs in between base rate case filings with the PWAC reset to zero once those increased costs are included in base rates. A PWAC is subject to an annual true-up. The current PWAC rate became effective November 1, 2016. The current filing includes the true-up and a request to recover additional annual costs of \$1.2 million for the purchase of untreated water from the New Jersey Water Supply Authority (NJWSA). The NJWSA increased the rate it charges its subscribers on July 1, 2017. The Company expects that the NJBPU will approve the PWAC rate reset by October 2017 with an effective date of November 1, 2017.

Tidewater Distribution System Improvement Charge (DSIC) - Effective July 1, 2017, Tidewater reset its Delaware Public Service Commission-approved DSIC rate, which is expected to generate \$0.4 million of annual revenues. A DSIC is a rate-mechanism that allows water utilities to recover investments in, and generate a return on,

qualifying capital improvements to their water distribution system made between base rate proceedings.

Outlook

Favorable weather patterns and additional sales to neighboring municipal water utilities due to emergency conditions experienced by those entities in 2015 and 2016, which contributed to overall increases in operating revenues during those periods, have not reoccurred in 2017 through June 30th and may not occur for the remainder of 2017. Changes in customer water usage habits, as well as increases in capital expenditures and operating costs, are significant factors in determining the timing and extent of rate increase requests. As operating costs are anticipated to increase in 2017 in a variety of categories, we continue to implement plans to further streamline operations and further reduce, and mitigate increases in, operating costs.

Index

Organic residential customer growth for 2017, largely the result of new housing from developer activity in Delaware is expected to be consistent with that experienced in recent years.

Our strategy for profitable growth is focused on five key areas:

- Prudent acquisitions of investor- and municipally-owned water and wastewater utilities;
- Timely and adequate recovery of prudent investments in utility plant required to maintain appropriate utility services;
- Operate municipal, commercial and industrial water and wastewater systems under contract;
- Invest in, and/or operate under contract, renewable energy and industrial and commercial treatment projects that are complementary to the provision of water and wastewater services and related competencies; and
- Invest in other products, services and opportunities that complement our core water and wastewater competencies.

Operating Results by Segment

The discussion of the Company's operating results is on a consolidated basis and includes significant factors by subsidiary. The Company has two operating segments, Regulated and Non-Regulated. The operations of the Regulated segment are subject to regulations promulgated by state public utility commissions as to rates and level of service. Rates and level service in the Non-Regulated segment are subject to the terms of individually-negotiated and executed contracts with municipal, industrial and other clients. Both segments are subject to federal and state environmental, water and wastewater quality and other associated legal and regulatory requirements.

The segments in the tables included below consist of the following companies: Regulated-Middlesex, Tidewater, Pinelands, Southern Shores, TESI and Twin Lakes; Non-Regulated-USA, USA-PA, and White Marsh.

Results of Operations – Three Months Ended June 30, 2017

(In Thousands)
Three Months Ended June 30,

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

	2017			2016		
	<u>Regulated</u>	<u>Non-Regulated</u>	Total	<u>Regulated</u>	<u>Non-Regulated</u>	Total
Revenues	\$29,252	\$ 3,762	\$33,014	\$28,832	\$ 3,893	\$32,725
Operations and maintenance expenses	13,709	2,942	16,651	12,665	3,124	15,789
Depreciation expense	3,337	48	3,385	3,133	47	3,180
Other taxes	3,329	86	3,415	3,340	88	3,428
Operating income	8,877	686	9,563	9,694	634	10,328
Other income, net	175	30	205	143	(6)	137
Interest expense	1,469	—	1,469	1,436	—	1,436
Income taxes	2,611	307	2,918	2,818	292	3,110
Net income	\$4,972	\$ 409	\$5,381	\$5,583	\$ 336	\$5,919

Index

Operating Revenues

Operating revenues for the three months ended June 30, 2017 increased \$0.3 million from the same period in 2016.

- Tidewater System revenues increased \$0.5 million due to additional residential customers; and
- Middlesex System revenues decreased \$0.2 million due to lower water usage across all classes of customers.

Operation and Maintenance Expense

Operation and maintenance expenses for the three months ended June 30, 2017 increased \$0.9 million from the same period in 2016, primarily related to the following factors:

Higher water production costs of \$0.5 million in the Middlesex System, primarily due to a rate increase in the water treatment residuals disposal process and lower raw water quality;

- Higher labor costs of \$0.3 million, primarily due to higher average labor rates and increased headcount required to address additional regulatory and other needs; and

- All other operation and maintenance expense categories increased \$0.1 million.

Depreciation

Depreciation expense for the three months ended June 30, 2017 increased \$0.2 million from the same period in 2016 due to a higher level of utility plant in service.

Other Taxes

Other taxes for the three months ended June 30, 2017 were consistent with the same period in 2016. Higher payroll taxes were offset by lower revenue related taxes on decreased revenues in our Middlesex system.

Other Income, net

Other Income, net for the three months ended June 30, 2017 increased \$0.1 million from the same period in 2016, due to a higher allowance for funds used during construction (AFUDC), resulting from a higher level of capital projects in progress.

Interest Charges

Interest charges for the three months ended June 30, 2017 remained consistent with the same period in 2016.

Income Taxes

Income taxes for the three months ended June 30, 2017 decreased \$0.2 million from the same period in 2016, due to lower pre-tax income in 2017 as compared to 2016.

Net Income and Earnings Per Share

Net income for the three months ended June 30, 2017 decreased \$0.5 million as compared with the same period in 2016. Basic and diluted earnings per share were \$0.33 and \$0.36 for the three months ended June 30, 2017 and 2016, respectively.

Index**Results of Operations – Six Months Ended June 30, 2017**

	(In Thousands)					
	Six Months Ended June 30, 2017			2016		
	<u>Regulated</u>	<u>Non-Regulated</u>	Total	<u>Regulated</u>	<u>Non-Regulated</u>	Total
Revenues	\$55,734	\$ 7,411	\$63,145	\$55,767	\$ 7,537	\$63,304
Operations and maintenance expenses	26,496	5,889	32,385	25,548	6,069	31,617
Depreciation expense	6,596	97	6,693	6,225	92	6,317
Other taxes	6,545	179	6,724	6,568	172	6,740
Operating income	16,097	1,246	17,343	17,426	1,204	18,630
Other income, net	295	30	325	233	(6) 227
Interest expense	2,472	—	2,472	2,413	—	2,413
Income taxes	4,809	565	5,374	5,173	562	5,735
Net income	\$9,111	\$ 711	\$9,822	\$10,073	\$ 636	\$10,709

Operating Revenues

Operating revenues for the six months ended June 30, 2017 decreased \$0.2 million from the same period in 2016.

- Middlesex System revenues decreased \$1.0 million due to lower water usage across all classes of customers;
- Tidewater System revenues increased \$0.9 million due to additional residential customers; and
- All other operating revenue categories decreased \$0.1 million.

Operation and Maintenance Expense

Operation and maintenance expenses for the six months ended June 30, 2017 increased \$0.8 million from the same period in 2016, primarily related to the following factors:

- Higher water production costs of \$0.7 million in the Middlesex System, primarily due to a rate increase in the water treatment residuals disposal process and lower raw water quality;
- Higher labor costs of \$0.5 million, primarily due to higher average labor rates and increased headcount required to address additional regulatory and other needs;
- Decreased liability insurance costs of \$0.3 million due to prior policy year refunds; and

All other operation and maintenance expense categories decreased \$0.1 million.

Depreciation

Depreciation expense for the six months ended June 30, 2017 increased \$0.4 million from the same period in 2016 due to a higher level of utility plant in service.

Other Taxes

Other taxes for the six months ended June 30, 2017 were consistent with the same period in 2016. Higher payroll taxes were offset by lower revenue related taxes on decreased revenues in our Middlesex system.

Other Income, net

Other Income, net for the six months ended June 30, 2017 increased \$0.1 million from the same period in 2016 due to higher AFUDC, resulting from a higher level of capital projects in progress.

Index

Interest Charges

Interest charges for the six months ended June 30, 2017 increased \$0.1 million from the same period in 2016 due to higher average short-term debt balances outstanding and higher average interest rates on short-term debt.

Income Taxes

Income taxes for the six months ended June 30, 2017 decreased \$0.4 million from the same period in 2016, due to lower pre-tax income in 2017 as compared to 2016.

Net Income and Earnings Per Share

Net income for the six months ended June 30, 2017 decreased \$0.9 million as compared with the same period in 2016. Basic earnings per share were \$0.60 and \$0.65 for the six months ended June 30, 2017 and 2016, respectively. Diluted earnings per share were \$0.59 and \$0.65 for the six months ended June 30, 2017 and 2016, respectively.

Liquidity and Capital Resources

Operating Cash Flows

Cash flows from operations are largely based on four factors: weather, adequate and timely rate increases, effective cost management and growth. The effect of those factors on net income is discussed in “Results of Operations.”

For the six months ended June 30, 2017, cash flows from operating activities increased \$3.4 million to \$20.2 million. The increase in cash flows from operating activities primarily resulted from lower income tax payments and decreased inventory purchases. The \$20.2 million of net cash flow from operations enabled the Company to fund approximately 72% of utility plant expenditures internally for the period.

Investing Cash Flows

For the six months ended June 30, 2017, cash flows used in investing activities increased \$1.1 million to \$21.2 million. The increase in cash flows used in investing activities resulted from higher utility plant expenditures.

For further discussion on the Company's future capital expenditures and expected funding sources, see "*Capital Expenditures and Commitments*" below.

Financing Cash Flows

For the six months ended June 30, 2017, cash flows from financing activities decreased \$0.3 million to \$0.8 million. The decrease in cash flows from financing activities resulted from increased common stock dividend payments and lower proceeds from sales of common stock under the Middlesex Water Company Investment Plan (the Investment Plan) offset by an increase in short-term and long-term debt funding.

Capital Expenditures and Commitments

To fund our capital program, we use internally generated funds, short-term and long-term debt borrowings, proceeds from sales of common stock under the Investment Plan and proceeds from sales offerings to the public of our common stock. See below for a more detailed discussion regarding the funding of our capital program.

The capital investment program for 2017 is currently estimated to be approximately \$60 million. Through June 30, 2017, we have expended \$21.2 million and expect to incur approximately \$39 million for capital projects for the remainder of 2017.

We currently project that we may expend approximately \$163 million for capital projects in 2018 and 2019. The actual amount and timing of capital expenditures is dependent on project scheduling and refinement of engineering estimates for certain capital projects.

Index

To pay for our capital program for the remainder of 2017, we plan on utilizing:

Internally generated funds;

Proceeds from the Investment Plan;

Requisition funding from active construction loans under the New Jersey State Revolving Fund (SRF) program (approximately \$10.0 million depending on actual construction schedule). The SRF program provides low cost financing for projects that meet certain water quality and system improvement benchmarks; and
Short-term borrowings, as needed, through \$60.0 million of available lines of credit with several financial institutions. As of June 30, 2017, there remains \$43.0 million of available credit under these lines.

Recent Accounting Pronouncements – See Note 1 of the Notes to Unaudited Condensed Consolidated Financial Statements for a discussion of recent accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures of Market Risk

We are exposed to market risk associated with changes in interest rates and commodity prices. The Company is subject to the risk of fluctuating interest rates in the normal course of business. Our policy is to manage interest rates through the use of fixed rate long-term debt and, to a lesser extent, short-term debt. The Company's interest rate risk related to existing fixed rate, long-term debt is not material due to the term of the majority of our First Mortgage Bonds, which have final maturity dates ranging from 2018 to 2047. Over the next twelve months, approximately \$6.2 million of the current portion of existing long-term debt instruments will mature. Applying a hypothetical 10% change in the rate of interest charged on those borrowings would not have a material effect on our earnings.

Our risks associated with commodity price increases for chemicals, electricity and other commodities are reduced through contractual arrangements and the ability to recover market-based price increases through customers' rates. Non-performance by these commodity suppliers could have a material adverse impact on our results of operations, financial position and cash flows.

We are exposed to credit risk for both our Regulated and Non-Regulated business segments. Our Regulated operations serve residential, commercial, industrial and municipal customers while our Non-Regulated operations engage in business activities with developers, government entities and other customers. Our primary credit risk is exposure to customer default on contractual obligations and the associated loss that may be incurred due to the non-payment of customer accounts receivable balances. Our credit risk is managed through established credit and collection policies which are in compliance with applicable regulatory requirements and involve monitoring of customer exposure and the use of credit risk mitigation measures such as letters of credit or prepayment arrangements. Our credit portfolio is diversified with no significant customer or industry concentrations. In addition, our Regulated businesses are generally able to recover all prudently incurred costs including uncollectible customer accounts receivable expenses and collection costs through rates.

The Company's retirement benefit plan assets are exposed to fluctuating market prices of debt and equity securities. Changes to the Company's retirement benefit plan assets' value can impact the Company's retirement benefit plan expense, funded status and future minimum funding requirements. Our risk is reduced through our ability to recover retirement benefit plan costs through rates.

Index

Item 4. Controls and Procedures

Disclosure Controls and Procedures

As required by Rule 13a-15 under the Securities and Exchange Act of 1934 (the Exchange Act), an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was conducted by the Company's Chief Executive Officer along with the Company's Chief Financial Officer. Based upon that evaluation, the Company's Chief Executive Officer and the Company's Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this Report. There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in Company reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in Company reports filed under the Exchange Act is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer as appropriate, to allow timely decisions regarding disclosure.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

The information about risk factors does not differ materially from those set forth in Part I, Item 1A. of the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Index

Item 6. Exhibits

10.46 Copy of Construction Loan Agreement (CFP 17-1) By and Between New Jersey Environmental Infrastructure Trust and Middlesex Water Company

31.1 Section 302 Certification by Dennis W. Doll pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

31.2 Section 302 Certification by A. Bruce O'Connor pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

32.1 Section 906 Certification by Dennis W. Doll pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.2 Section 906 Certification by A. Bruce O'Connor pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

101.INSXBRL Instance Document

101.SCHXBRL Schema Document

101.CALXBRL Calculation Linkbase Document

101.LABXBRL Labels Linkbase Document

101.PREXBRL Presentation Linkbase Document

101.DEF XBRL Definition Linkbase Document

Index

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MIDDLESEX WATER
COMPANY

By: /s/A. Bruce O'Connor
A. Bruce O'Connor
Vice President, Treasurer and
Chief Financial Officer
(Principal Accounting Officer)

Date: August 1, 2017