

MIDDLESEX WATER CO
Form 10-Q
November 06, 2014

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 September 30, 2014

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

(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 or a smaller reporting company.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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 October 31, 2014:
Common Stock, No Par Value: 16,111,268 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>	13
<u>Item 3. Quantitative and Qualitative Disclosures of Market Risk</u>	22
<u>Item 4. Controls and Procedures</u>	22
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	23
<u>Item 1A. Risk Factors</u>	23
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	23
<u>Item 3. Defaults upon Senior Securities</u>	23
<u>Item 4. Mine Safety Disclosures</u>	23
<u>Item 5. Other Information</u>	23
<u>Item 6. Exhibits</u>	24
<u>SIGNATURES</u>	25

Index

MIDDLESEX WATER COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands except per share amounts)

	Three Months Ended September		Nine Months Ended September	
	30,	2013	30,	2013
	2014		2014	
Operating Revenues	\$ 32,669	\$ 31,285	\$ 89,032	\$ 87,424
Operating Expenses:				
Operations and Maintenance	14,956	15,120	44,957	45,698
Depreciation	2,880	2,772	8,532	8,205
Other Taxes	3,213	3,123	9,210	9,215
Total Operating Expenses	21,049	21,015	62,699	63,118
Operating Income	11,620	10,270	26,333	24,306
Other Income (Expense):				
Allowance for Funds Used During Construction	80	104	213	230
Other Income	49	27	195	124
Other Expense	(44)	(1)	(218)	(21)
Total Other Income, net	85	130	190	333
Interest Charges	1,516	1,541	4,134	4,234
Income before Income Taxes	10,189	8,859	22,389	20,405
Income Taxes	3,431	3,052	7,735	6,940
Net Income	6,758	5,807	14,654	13,465
Preferred Stock Dividend Requirements	36	44	115	147
Earnings Applicable to Common Stock	\$ 6,722	\$ 5,763	\$ 14,539	\$ 13,318
Earnings per share of Common Stock:				
Basic	\$ 0.42	\$ 0.36	\$ 0.91	\$ 0.84
Diluted	\$ 0.42	\$ 0.36	\$ 0.90	\$ 0.83

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

Average Number of
Common Shares Outstanding :

Basic	16,097	15,882	16,030	15,839
Diluted	16,253	16,117	16,211	16,093
Cash Dividends Paid per Common Share	\$ 0.1900	\$ 0.1875	\$ 0.5700	\$ 0.5625

See Notes to Condensed Consolidated Financial Statements.

1

Index

MIDDLESEX WATER COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands)

		September 30, 2014	December 31, 2013
ASSETS			
UTILITY PLANT:	Water Production	\$ 136,170	\$ 132,834
	Transmission and Distribution	366,966	359,931
	General	57,744	55,670
	Construction Work in Progress	11,142	8,410
	TOTAL	572,022	556,845
	Less Accumulated Depreciation	115,492	110,366
	UTILITY PLANT - NET	456,530	446,479
CURRENT ASSETS:			
	Cash and Cash Equivalents	5,052	4,834
	Accounts Receivable, net	11,153	11,640
	Unbilled Revenues	7,427	5,652
	Materials and Supplies (at average cost)	2,138	1,984
	Prepayments	2,981	1,728
	TOTAL CURRENT ASSETS	28,751	25,838
DEFERRED CHARGES AND OTHER ASSETS:			
	Unamortized Debt Expense	3,451	3,526
	Preliminary Survey and Investigation Charges	2,781	4,728
	Regulatory Assets	34,023	34,386
	Operations Contracts, Developer and Other Receivables	3,587	2,744
	Restricted Cash	3,438	2,473
	Non-utility Assets - Net	9,254	9,440
	Other	683	727
	TOTAL DEFERRED CHARGES AND OTHER ASSETS	57,217	58,024
	TOTAL ASSETS	\$ 542,498	\$ 530,341
CAPITALIZATION AND LIABILITIES			
CAPITALIZATION:			
	Common Stock, No Par Value	\$ 148,186	\$ 146,185
	Retained Earnings	47,977	42,560
	TOTAL COMMON EQUITY	196,163	188,745
	Preferred Stock	2,436	2,886
	Long-term Debt	129,170	129,798
	TOTAL CAPITALIZATION	327,769	321,429
CURRENT LIABILITIES:			
	Current Portion of Long-term Debt	5,634	5,386
	Notes Payable	30,500	28,450

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

Accounts Payable	7,193	6,328
Accrued Taxes	10,563	8,132
Accrued Interest	431	1,151
Unearned Revenues and Advanced Service Fees	852	837
Other	1,518	2,394
TOTAL CURRENT LIABILITIES	56,691	52,678

COMMITMENTS AND CONTINGENT LIABILITIES (Note 7)

DEFERRED CREDITS AND OTHER LIABILITIES:	Customer Advances for Construction	21,336	21,837
	Accumulated Deferred Investment Tax Credits	930	989
	Accumulated Deferred Income Taxes	41,254	39,110
	Employee Benefit Plans	18,708	21,335
	Regulatory Liability - Cost of Utility Plant Removal	10,044	9,639
	Other	1,322	1,348
	TOTAL DEFERRED CREDITS AND OTHER LIABILITIES	93,594	94,258
CONTRIBUTIONS IN AID OF CONSTRUCTION		64,444	61,976
TOTAL CAPITALIZATION AND LIABILITIES		\$ 542,498	\$ 530,341

See Notes to Condensed Consolidated Financial Statements.

Index

MIDDLESEX WATER COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$ 14,654	\$ 13,465
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	9,091	8,833
Provision for Deferred Income Taxes and Investment Tax Credits	2,107	2,536
Equity Portion of Allowance for Funds Used During Construction (AFUDC)	(138)	(149)
Cash Surrender Value of Life Insurance	(81)	(174)
Stock Compensation Expense	430	357
Changes in Assets and Liabilities:		
Accounts Receivable	687	135
Unbilled Revenues	(1,775)	(1,510)
Materials & Supplies	(154)	(585)
Prepayments	(1,253)	(436)
Accounts Payable	867	566
Accrued Taxes	2,431	(42)
Accrued Interest	(720)	(513)
Employee Benefit Plans	(2,720)	(1,033)
Unearned Revenue and Advanced Service Fees	15	(1)
Other Assets and Liabilities	(1,002)	(284)
NET CASH PROVIDED BY OPERATING ACTIVITIES	22,439	21,165
CASH FLOWS FROM INVESTING ACTIVITIES:		
Utility Plant Expenditures, Including AFUDC of \$75 in 2014, \$81 in 2013	(15,783)	(14,585)
Restricted Cash	(965)	(360)
Distribution From / (Investment in) Joint Venture	782	(1,205)
NET CASH USED IN INVESTING ACTIVITIES	(15,966)	(16,150)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Redemption of Long-term Debt	(4,678)	(10,440)
Proceeds from Issuance of Long-term Debt	4,398	3,987
Net Short-term Bank Borrowings	2,050	2,500
Deferred Debt Issuance Expense	(69)	(55)
Restricted Cash	—	6,070
Proceeds from Issuance of Common Stock	1,120	1,257
Payment of Common Dividends	(9,130)	(8,902)
Payment of Preferred Dividends	(115)	(147)

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

Construction Advances and Contributions-Net	169		627	
NET CASH USED IN FINANCING ACTIVITIES	(6,255)	(5,103)
NET CHANGES IN CASH AND CASH EQUIVALENTS	218		(88)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	4,834		3,025	
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 5,052		\$ 2,937	

SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITY:

Utility Plant received as Construction Advances and Contributions	\$ 1,797		\$ 1,324	
Long-term Debt Deobligation	\$ —		\$ 64	

SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:

Cash Paid During the Year for:				
Interest	\$ 4,971		\$ 4,875	
Interest Capitalized	\$ 75		\$ 81	
Income Taxes	\$ 3,775		\$ 5,169	

See Notes to Condensed Consolidated Financial Statements.

Index

MIDDLESEX WATER COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CAPITAL STOCK

AND LONG-TERM DEBT

(Unaudited)

(In thousands)

	September 30, 2014	December 31, 2013
Common Stock, No Par Value		
Shares Authorized - 40,000		
Shares Outstanding - 2014 - 16,107	\$ 148,186	\$ 146,185
2013 - 15,963		
Retained Earnings	47,977	42,560
TOTAL COMMON EQUITY	\$ 196,163	\$ 188,745
Cumulative Preferred Stock, No Par Value:		
Shares Authorized - 130		
Shares Outstanding - 24 - 2014; 28 - 2013		
Convertible:		
Shares Outstanding, \$7.00 Series - 10 - 2014; 14 - 2013	1,007	1,457
Shares Outstanding, \$8.00 Series - 3	349	349
Nonredeemable:		
Shares Outstanding, \$7.00 Series - 1	80	80
Shares Outstanding, \$4.75 Series - 10	1,000	1,000
TOTAL PREFERRED STOCK	\$ 2,436	\$ 2,886
Long-term Debt:		
8.05%, Amortizing Secured Note, due December 20, 2021	\$ 1,872	\$ 2,005
6.25%, Amortizing Secured Note, due May 19, 2028	5,740	6,055
6.44%, Amortizing Secured Note, due August 25, 2030	4,457	4,667
6.46%, Amortizing Secured Note, due September 19, 2031	4,737	4,947
4.22%, State Revolving Trust Note, due December 31, 2022	443	465
3.60%, State Revolving Trust Note, due May 1, 2025	2,559	2,654
3.30% State Revolving Trust Note, due March 1, 2026	506	541
3.49%, State Revolving Trust Note, due January 25, 2027	536	569
4.03%, State Revolving Trust Note, due December 1, 2026	720	742
4.00% to 5.00%, State Revolving Trust Bond, due August 1, 2021	299	343
0.00%, State Revolving Fund Bond, due August 1, 2021	241	281
3.64%, State Revolving Trust Note, due July 1, 2028	322	330
3.64%, State Revolving Trust Note, due January 1, 2028	107	110
3.45%, State Revolving Trust Note, due August 1, 2031	1,115	467

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

6.59%, Amortizing Secured Note, due April 20, 2029	5,087	5,348
7.05%, Amortizing Secured Note, due January 20, 2030	3,833	4,021
5.69%, Amortizing Secured Note, due January 20, 2030	7,863	8,248
3.75%, State Revolving Trust Note, due July 1, 2031	2,463	2,515
3.75%, State Revolving Trust Note, due November 30, 2030	1,304	1,333
First Mortgage Bonds:		
0.00%, Series X, due September 1, 2018	215	268
4.25% to 4.63%, Series Y, due September 1, 2018	245	300
0.00%, Series Z, due September 1, 2019	559	671
5.25% to 5.75%, Series AA, due September 1, 2019	700	830
0.00%, Series BB, due September 1, 2021	845	965
4.00% to 5.00%, Series CC, due September 1, 2021	1,025	1,145
0.00%, Series EE, due August 1, 2023	3,550	3,968
3.00% to 5.50%, Series FF, due August 1, 2024	4,900	5,335
0.00%, Series GG, due August 1, 2026	1,083	1,171
4.00% to 5.00%, Series HH, due August 1, 2026	1,390	1,475
0.00%, Series II, due August 1, 2024	881	971
3.40% to 5.00%, Series JJ, due August 1, 2027	1,090	1,165
0.00%, Series KK, due August 1, 2028	1,255	1,346
5.00% to 5.50%, Series LL, due August 1, 2028	1,435	1,505
0.00%, Series MM, due August 1, 2030	1,537	1,637
3.00% to 4.375%, Series NN, due August 1, 2030	1,755	1,835
0.00%, Series OO, due August 1, 2031	2,559	2,709
2.00% to 5.00%, Series PP, due August 1, 2031	850	885
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	2,709	2,860
3.00% to 3.25%, Series UU, due August 1, 2032	975	1,015
0.00%, Series VV, due August 1, 2033	2,720	—
3.00% to 5.00%, Series WW, due August 1, 2033	935	—
SUBTOTAL LONG-TERM DEBT	132,832	133,112
Add: Premium on Issuance of Long-term Debt	1,972	2,072
Less: Current Portion of Long-term Debt	(5,634)	(5,386)
TOTAL LONG-TERM DEBT	\$ 129,170	\$ 129,798

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 2013 Annual Report on Form 10-K (the 2013 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 September 30, 2014, the results of operations for the three month and nine month periods ended September 30, 2014, and 2013 and cash flows for the nine month periods ended September 30, 2014, and 2013. Information included in the Condensed Consolidated Balance Sheet as of December 31, 2013, has been derived from the Company's audited financial statements for the year ended December 31, 2013 included in the 2013 Form 10-K. These condensed financial statements should be read in conjunction with the financial statements and notes included in the Company's 2013 Form 10-K.

Recent Accounting Guidance

In May 2014, the Financial Accounting Standards Board issued an update to authoritative 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 guidance will be effective for the Company beginning January 1, 2017. Early adoption is not permitted. The new guidance must be applied retrospectively to each prior period presented or retrospectively via a cumulative effect upon the date of initial application. We are currently evaluating the impact that the adoption will have on our consolidated financial statements and related disclosures.

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

Note 2 – Rate and Regulatory Matters

Middlesex – In June 2014, Middlesex’s application with the New Jersey Board of Public Utilities (NJBPU) seeking permission to increase base water rates was partially approved, granting an increase in annual operating revenues of \$4.2 million. The originally-filed base water rate increase request of \$10.6 million, filed in November 2013 (subsequently revised to \$8.1 million, primarily resulting from lower employee benefit plan costs), was necessitated by capital investments Middlesex had made, or committed to make, increased operations and maintenance costs and lost revenues resulting from the ending of a wholesale water sales contract with the Borough of Sayreville, New Jersey in August 2013 and Middlesex’s largest retail water customer, Hess Corporation, ceasing its oil refining operations at its Port Reading, New Jersey facility in February 2013. The new base water rates are designed to recover the increased costs, lost revenues, as well as a return on invested capital in rate base of \$208.6 million based on a return on equity of 9.75%. The rate increase became effective on July 20, 2014.

In May 2014, Middlesex filed a petition with the NJBPU seeking approval of foundational information (Foundational Filing) that would allow for the implementation of a Distribution System Improvement Charge (DSIC). A DSIC is a rate-mechanism that allows water utilities to recover investment in capital improvements to their water distribution system made between base rate proceedings. In August 2014, the Foundational Filing was approved by the NJBPU, which allows Middlesex to implement a DSIC rate in September 2014 to recover costs for qualifying projects that are placed in service in the six-month post-approval period. The DSIC rate is allowed to increase in three subsequent six month periods for any additional qualifying projects placed in service during those time periods. The maximum annual revenue allowed to be recovered under the approved Foundational Filing is \$3.6 million.

Index

Tidewater – The Delaware Public Service Commission (DEPSC) approved a \$0.8 million increase in Tidewater’s annual base water rates, effective August 19, 2014. The originally-filed base water rate increase request of \$3.9 million, filed in November 2013 (subsequently revised to \$2.5 million, primarily resulting from lower employee benefit plan costs), was necessitated by capital investments Tidewater had made, or committed to make, as well as increased operations and maintenance costs. In connection with the rate increase application, Tidewater implemented a DEPSC approved 6.5% interim rate increase, subject to refund, on February 6, 2014. Since the final approved rate increase was less than the interim rate increase, Tidewater refunded \$0.4 million of previously deferred revenues to customers in the form of a one-time credit to each customer account.

In April 2014, the DEPSC approved Tidewater’s agreement with the United States Department of Defense for the privatization of the water system of Dover Air Force Base (DAFB) in Dover, Delaware. On October 1, 2014, Tidewater began providing DAFB with potable water service. Based on the recently implemented DEPSC-approved Tidewater base water rate increase, service to DAFB is expected to generate approximately \$0.6 million of revenue annually.

TESI - The DEPSC approved an April 2014 request by TESI to relinquish its Certificate of Public Necessity and Convenience (“CPCN”) for a real estate parcel in Sussex County, Delaware. This approval allowed for a companion transaction to be completed, whereby TESI was reimbursed with a combination of cash and a future receivable by a real estate developer for \$1.9 million of Preliminary Survey and Investigation Costs incurred in connection with the CPCN. TESI recognized a gain of less than \$0.1 million from this transaction.

Note 3 – Capitalization

Common Stock

During the nine months ended September 30, 2014 and 2013, there were 54,627 common shares (approximately \$1.1 million) and 63,649 common shares (approximately \$1.3 million), respectively, issued under the Company’s Amended and Restated Dividend Reinvestment and Common Stock Purchase Plan.

For the nine months ended September 30, 2014, 4,293 shares (approximately \$0.5 million) of the Company’s no par \$7.00 Series Cumulative and Convertible Preferred Stock were converted into 51,516 shares of common stock.

Long-term Debt

In May 2014, Middlesex borrowed approximately \$3.8 million through the New Jersey Environmental Infrastructure Trust under the New Jersey State Revolving Fund (SRF) loan program and issued first mortgage bonds designated as Series VV (approximately \$2.8 million) and Series WW (approximately \$0.9 million). The interest rate on the Series

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

VV bond is zero and the interest rate on the Series WW bond ranges from 3.0% to 5.0% depending on the serial maturity date. The final maturity date for both bonds is August 1, 2033. Proceeds were recorded as Restricted Cash and may only be used for the Middlesex 2014 RENEW project, which is part of a program to clean and cement all unlined mains in the Middlesex system.

In October 2014, Tidewater closed on a \$15.0 million DEPSC-approved loan. Tidewater can borrow the \$15.0 million in whole or in increments at its discretion until April 30, 2015, at an interest rate based on market conditions at the time of borrowing with a maximum final maturity date of April 1, 2040. Proceeds from the loan will be used to retire short-term borrowings and also fund Tidewater's ongoing capital program.

Index*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 the Company's long-term debt relating to First Mortgage and SRF Bonds (Bonds) is based on quoted market prices for similar issues. Under the fair value hierarchy, the fair value of cash and cash equivalents is classified as a Level 1 measurement and the fair value of the Bonds in the table below are classified as Level 2 measurements.

The carrying amount and fair value of the Company's bonds were as follows:

	September 30, 2014		December 31, 2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
First Mortgage Bonds	\$ 88,628	\$ 88,532	\$ 87,471	\$ 79,733
SRF Bonds	\$ 540	\$ 542	\$ 625	\$ 628

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" and "State Revolving Trust Note" on the Condensed Consolidated Statements of Capital Stock and Long-Term Debt). The carrying amount of these instruments was \$43.7 million at September 30, 2014 and \$45.0 million at December 31, 2013. Customer advances for construction have carrying amounts of \$21.3 million and \$21.8 million, respectively, at September 30, 2014 and December 31, 2013. 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.

Three Months Ended September 30,	
2014	2013

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

Basic:	Income	Shares	Income	Shares
Net Income	\$6,758	16,097	\$5,807	15,882
Preferred Dividend	(36)		(44)	
Earnings Applicable to Common Stock	\$6,722	16,097	\$5,763	15,882
Basic EPS	\$0.42		\$0.36	
Diluted:				
Earnings Applicable to Common Stock	\$6,722	16,097	\$5,763	15,882
\$7.00 Series Preferred Dividend	17	115	24	167
\$8.00 Series Preferred Dividend	6	41	6	68
Adjusted Earnings Applicable to Common Stock	\$6,745	16,253	\$5,793	16,117
Diluted EPS	\$0.42		\$0.36	

7

Index

	(In Thousands Except per Share Amounts)			
	Nine Months Ended September 30,			
	2014		2013	
Basic:	Income	Shares	Income	Shares
Net Income	\$ 14,654	16,030	\$ 13,465	15,839
Preferred Dividend	(115)		(147)	
Earnings Applicable to Common Stock	\$ 14,539	16,030	\$ 13,318	15,839
Basic EPS	\$ 0.91		\$ 0.84	
Diluted:				
Earnings Applicable to Common Stock	\$ 14,539	16,030	\$ 13,318	15,839
\$7.00 Series Preferred Dividend	57	140	73	167
\$8.00 Series Preferred Dividend	18	41	34	87
Adjusted Earnings Applicable to Common Stock	\$ 14,614	16,211	\$ 13,425	16,093
Diluted EPS	\$ 0.90		\$ 0.83	

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		Nine Months Ended	
	September 30,		September 30,	
Operations by Segments:	2014	2013	2014	2013
Revenues:				
Regulated	\$29,346	\$27,981	\$78,719	\$77,042
Non – Regulated	3,492	3,470	10,752	10,787
Inter-segment Elimination	(169)	(166)	(439)	(405)
Consolidated Revenues	\$32,669	\$31,285	\$89,032	\$87,424
Operating Income:				
Regulated	\$11,039	\$9,685	\$24,585	\$22,699
Non – Regulated	581	585	1,748	1,607
Consolidated Operating Income	\$11,620	\$10,270	\$26,333	\$24,306
Net Income:				
Regulated	\$6,458	\$5,505	\$13,753	\$12,648
Non – Regulated	300	302	901	817
Consolidated Net Income	\$6,758	\$5,807	\$14,654	\$13,465
Capital Expenditures:				
Regulated	\$7,211	\$4,313	\$15,685	\$14,417
Non – Regulated	67	50	98	168
Total Capital Expenditures	\$7,278	\$4,363	\$15,783	\$14,585
	As of	As of		
	September 30,	December 31,		
	2014	2013		
Assets:				
Regulated	\$ 540,970	\$ 529,381		
Non – Regulated	8,262	8,887		
Inter-segment Elimination	(6,734)	(7,927)		
Consolidated Assets	\$ 542,498	\$ 530,341		

Note 6 – Short-term Borrowings

As of September 30, 2014, the Company has established lines of credit aggregating \$60.0 million. At September 30, 2014, the outstanding borrowings under these credit lines were \$30.5 million at a weighted average interest rate of 1.47%.

Index

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 Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Average Daily Amounts Outstanding	\$28,832	\$28,608	\$27,906	\$27,472
Weighted Average Interest Rates	1.44%	1.32%	1.44%	1.35%

The maturity dates for the \$30.5 million outstanding as of September 30, 2014 are all in October 2014 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 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, 2016, provides for the minimum purchase of 3 mgd of treated water with provisions for additional purchases.

Purchased water costs are shown below:

(In Thousands)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Treated	\$764	\$780	\$ 2,344	\$ 2,303
Untreated	642	618	1,763	1,739
Total Costs	\$1,406	\$1,398	\$ 4,107	\$ 4,042

Contract Operations - USA-PA operates the City of Perth Amboy, New Jersey's 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 20-year 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 - In September 2013, Middlesex entered into agreements with Applied Water Management, Inc. (AWM), Natural Systems Utilities, LLC (NSU), the parent company of AWM, and the County of Monmouth, New Jersey (Monmouth County) for the design, construction and operation of a leachate pretreatment facility at the Monmouth County Reclamation Center in Tinton Falls, New Jersey. Under the terms of the agreements, AWM will obtain permits, design, build and operate the landfill leachate pretreatment facility and Middlesex will serve in the role of guarantor of AWM's performance on the project, in addition to providing operational support. Construction of the facility is being financed by Monmouth County and began in September 2014. Middlesex expects to act as guarantor of AWM's performance through at least August 2018 and is contractually obligated to act as guarantor of AWM's performance through 2028 unless another guarantor, acceptable to Monmouth County, is identified. Under agreements with AWM and NSU, Middlesex earns a fee for providing the guaranty of AWM's performance to Monmouth County, and AWM and NSU, serving as guarantor to Middlesex with respect to the performance of AWM, indemnify Middlesex against any claims that may arise under the Middlesex guaranty to Monmouth County.

Index

Middlesex believes it is unlikely any payments would need to be made under Middlesex's guaranty of AWM's performance to Monmouth County. If asked to perform under the guaranty to Monmouth 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 Monmouth County, Middlesex would be required to fulfill the construction and operational commitments of AWM. As of September 30, 2014, and December 31, 2013, the liability recognized in Other Non-Current Liabilities on the balance sheet for the guaranty is approximately \$0.3 million and \$0.4 million, respectively.

Construction

The Company expects to spend approximately \$26.6 million for its construction program in 2014. 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 maintains a defined benefit pension plan (Pension Plan) which covers all active employees hired prior to March 31, 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 a discretionary annual contribution into a self-directed retirement account based upon a percentage of the participants' base compensation. In order to be eligible for contribution, the participating employee must be employed by the Company on December 31st of the year to which the award relates. For the three months ended September 30, 2014 and 2013, the Company made cash contributions to the Pension Plan of \$1.3 million and \$1.9 million, respectively. For the nine months ended September 30, 2014 and 2013, the Company made cash contributions to the Pension Plan of \$2.5 million and \$2.6 million, respectively. The Company expects to make additional cash contributions to the Pension Plan of approximately \$0.8 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 maintains a postretirement plan other than pensions (Other Benefits Plan) which covers substantially all of its retired employees. Employees hired after March 31, 2007 are not eligible to participate in this plan. Coverage includes healthcare and life insurance. For the three months ended September 30, 2014 and 2013, the Company made cash contributions to the Other Benefits Plan of \$0.5 million and \$1.0 million, respectively. For the nine months ended September 30, 2014 and 2013, the Company made cash contributions to the Other Benefits Plan of \$0.9 million and \$1.7 million, respectively. The Company expects to make additional cash contributions to the Other Benefits Plan of approximately \$0.3 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			
	September 30,			
	2014	2013	2014	2013
Service Cost	\$473	\$575	\$258	\$334
Interest Cost	670	617	448	399
Expected Return on Assets	(883)	(724)	(484)	(406)
Amortization of Unrecognized Losses	104	408	353	516
Amortization of Unrecognized Prior Service Cost (Credit)	1	2	(432)	(432)
Net Periodic Benefit Cost	\$365	\$878	\$143	\$411

	(In Thousands)			
	Pension Benefits		Other Benefits	
	Nine Months Ended September 30,			
	2014	2013	2014	2013
Service Cost	\$1,420	\$1,725	\$774	\$1,003
Interest Cost	2,011	1,851	1,344	1,196
Expected Return on Assets	(2,650)	(2,171)	(1,453)	(1,217)
Amortization of Unrecognized Losses	312	1,224	1,060	1,549
Amortization of Unrecognized Prior Service Cost (Credit)	2	7	(1,296)	(1,296)
Net Periodic Benefit Cost	\$1,095	\$2,636	\$429	\$1,235

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, 2013.

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. These statements include, but are not limited to:

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

- the effects of general economic conditions;
- increases in competition in the markets served by the Company;
- the ability of the Company to control operating expenses and to achieve efficiencies in its operations;
- the availability of adequate supplies of water;
- actions taken by government regulators, including decisions on rate increase requests;
- new or additional water quality standards;
- weather variations and other natural phenomena;
- pursuit and integration of acquisitions of projects, systems or contracts that do not meet operational and/or financial expectations;

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

- acts of war or terrorism;
- cyber security incidents or failure of information technology systems;
- the pace of housing development in our regulated franchise areas and the resulting impact on customer growth;
- the availability and cost of capital resources;
- the ability to translate Preliminary Survey & Investigation charges into active projects; 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, 2013.

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.

We have an investment in a joint venture, Ridgewood Green RME, LLC, that owns and operates facilities to optimize the production of electricity at the Village of Ridgewood, New Jersey wastewater treatment plant and other municipal facilities.

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

USA offers residential customers in New Jersey and Delaware water service line and sewer lateral maintenance programs (LineCare). USA entered into a marketing agreement (the Agreement), expiring in 2021, with HomeServe USA (HomeServe), a leading provider of home maintenance service programs to service, develop and grow USA's LineCare customer base. USA receives a service fee for the billing, cash collection and other administrative matters associated with HomeServe's service contracts. USA also operates the Borough of Avalon, New Jersey's (Avalon) water utility, sewer utility and storm water system. In addition to performing the day to day operations, USA is responsible for billing, collections, customer service, emergency responses and management of capital projects funded

by Avalon. USA also provides unregulated water and wastewater services under contract with several New Jersey municipalities.

Our Delaware subsidiaries, Tidewater and Southern Shores Water Company, LLC (Southern Shores), provide water services to approximately 39,000 retail customers in New Castle, Kent and Sussex Counties, Delaware. Tidewater's subsidiary, White Marsh, services an additional 3,500 customers in Kent and Sussex Counties through various operations and maintenance contracts.

Our Tidewater Environmental Services, Inc. (TESI) subsidiary provides wastewater services to approximately 3,200 residential retail customers.

Index

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

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 prior periods.

Recent Developments

New Jersey Board of Public Utilities Approves Middlesex Base Water Rate Increase – In June 2014, Middlesex’s application with the New Jersey Board of Public Utilities (NJBPU) seeking permission to increase base water rates was partially approved, granting an increase in annual operating revenues of \$4.2 million. The originally-filed base water rate increase request of \$10.6 million, filed in November 2013 (subsequently revised to \$8.1 million, primarily resulting from lower employee benefit plan costs), was necessitated by capital investments Middlesex had made, or committed to make, increased operations and maintenance costs and lost revenues resulting from the ending of a wholesale water sales contract with the Borough of Sayreville, New Jersey in August 2013 and Middlesex’s largest retail water customer, Hess Corporation, ceasing its oil refining operations at its Port Reading, New Jersey facility in February 2013. The new base water rates are designed to recover the increased costs, lost revenues, as well as a return on invested capital in rate base of \$208.6 million based on a return on equity of 9.75%. The rate increase became effective on July 20, 2014.

Middlesex Implements Distribution System Improvement Charge – In May 2014, Middlesex filed a petition with the NJBPU seeking approval of foundational information (Foundational Filing) that would allow for the implementation of a Distribution System Improvement Charge (DSIC). A DSIC is a rate-mechanism that allows water utilities to recover investment in capital improvements to their water distribution system made between base rate proceedings. In August 2014, the Foundational Filing was approved by the NJBPU, which allows Middlesex to implement a DSIC rate in September 2014 to recover costs for qualifying projects that are placed in service in the six-month post-approval period. The DSIC rate is allowed to increase in three subsequent six month periods for any additional qualifying projects placed in service during those time periods. The maximum annual revenue allowed to be recovered under the approved Foundational Filing is \$3.6 million.

Delaware Public Service Commission Approves Tidewater Base Water Rate Increase –The Delaware Public Service Commission (DEPSC) approved a \$0.8 million increase in Tidewater’s annual base water rates, effective August 19, 2014. The originally-filed base water rate increase request of \$3.9 million, filed in November 2013 (subsequently revised to \$2.5 million, primarily resulting from lower employee benefit plan costs), was necessitated by capital investments Tidewater had made, or committed to make, as well as increased operations and maintenance costs. In connection with the rate increase application, Tidewater implemented a DEPSC approved 6.5% interim rate increase, subject to refund, on February 6, 2014. Since the final approved rate increase was less than the interim rate increase, Tidewater refunded \$0.4 million of previously deferred revenues to customers in the form of a one-time credit to each customer account.

Dover Air Force Base – In April 2014, the DEPSC approved Tidewater’s agreement with the United States Department of Defense for the privatization of the water system of Dover Air Force Base (DAFB) in Dover, Delaware. On October 1, 2014, Tidewater began providing DAFB with potable water service. Based on the recently implemented DEPSC-approved Tidewater base water rate increase, service to DAFB is expected to generate approximately \$0.6 million of revenue annually.

Index

Tidewater Loan – In October 2014, Tidewater closed on a \$15.0 million DEPSC-approved loan. Tidewater can borrow the \$15.0 million in whole or in increments at its discretion until April 30, 2015, at an interest rate based on market conditions at the time of borrowing with a maximum final maturity date of April 1, 2040. Proceeds from the loan will be used to retire short-term borrowings and also fund Tidewater’s ongoing capital program.

Outlook

Revenues for the remainder of 2014 are expected to be favorably impacted by Middlesex and Tidewater base water rate increases, (see “*New Jersey Board of Public Utilities Approves Middlesex Base Water Rate Increase*” and “*Delaware Public Service Commission Approves Tidewater Base Water Rate Increase*” above). In addition, revenues are expected to be favorably impacted by Tidewater’s agreement to provide water service to DAFB (beginning on October 1, 2014) and the full year effect of TESI’s Plantations development (Plantations) wastewater asset acquisition, which TESI began serving in October 2013.

Improved investment performance in 2013 of our retirement plan funds and a higher discount rate used for our actuarially-determined 2014 employee benefit plan expenses lowered our expenses and cash contributions in 2014. See Note 8 of the Notes to Unaudited Condensed Consolidated Financial Statements for further discussion of Employee Benefit Plans.

Revenues and earnings are influenced by weather. Changes in customer water usage patterns, number of customers and operating costs, as well as increases in capital expenditures, are the primary factors in determining the need for rate increase requests. We continue to implement plans to streamline operations and reduce operating costs in order to mitigate the level of rate increase requests.

As a result of the pace of new residential home construction, there may be an increase in the amount of preliminary survey and investigation (PS&I) costs that will not be recoverable in rates. If it is determined that recovery is unlikely, the applicable PS&I costs will be charged against income in the period of determination.

Our strategy is focused on four key areas:

- Acquire investor- and municipally-owned water and wastewater utilities;
- Operate municipal and industrial water and wastewater systems under contract;

· Invest in renewable energy projects that are complementary to the provision of water and wastewater services, and to our core water and wastewater 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 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.

Index**Results of Operations – Three Months Ended September 30, 2014**

	(In Thousands)					
	Three Months Ended September 30, 2014			2013		
	Regulated	Non-Regulated	Total	Regulated	Non-Regulated	Total
Revenues	\$29,266	\$ 3,403	\$32,669	\$27,905	\$ 3,380	\$31,285
Operations and maintenance expenses	12,261	2,695	14,956	12,451	2,669	15,120
Depreciation expense	2,835	45	2,880	2,726	46	2,772
Other taxes	3,131	82	3,213	3,043	80	3,123
Operating income	11,039	581	11,620	9,685	585	10,270
Other income, net	85	—	85	130	—	130
Interest expense	1,493	23	1,516	1,517	24	1,541
Income taxes	3,173	258	3,431	2,793	259	3,052
Net income	\$6,458	\$ 300	\$6,758	\$5,505	\$ 302	\$5,807

Operating Revenues

Operating revenues for the three months ended September 30, 2014 increased \$1.4 million from the same period in 2013. This increase was primarily related to the following factors:

- Middlesex System revenues increased \$0.4 million, primarily due to the following:
 - o Revenues from General Metered Service (GMS) customers increased by \$0.6 million, primarily due to the BPU-approved rate increase implemented in July 2014; and
 - o Contract Sales to Municipalities decreased by \$0.2 million primarily due to the loss of the Borough of Sayreville, New Jersey as a wholesale customer in August 2013 partially offset by the BPU-approved rate increase implemented in July 2014;
- Tidewater System revenues increased \$0.8 million, primarily due to the following:
 - o The implementation of a DEPSC-approved rate increase (approximately \$0.3 million); and
 - o Higher customer demand (approximately \$0.4 million);
 - o Increased fees for new customer connections to our water system (\$0.1 million) and
- USA's revenues increased \$0.2 million, primarily due to higher additional services revenues earned under USA's contract to operate the Avalon water utility, sewer utility and storm water system.

Operation and Maintenance Expense

Edgar Filing: MIDDLESEX WATER CO - Form 10-Q

Operation and maintenance expenses for the three months ended September 30, 2014 decreased \$0.2 million, primarily due to:

- Employee benefit expenses decreased \$0.6 million due primarily to lower postretirement employee benefit plan costs resulting from improved performance in 2013 on our investment of retirement plan funds and a higher discount rate used for the actuarially determined 2014 expense;
- Variable production costs decreased \$0.2 million primarily due to lower customer demand and higher water quality in our Middlesex System;
- Labor costs increased \$0.1 million, primarily related to higher average labor rates in 2014 as compared to 2013;

17

Index

Expenditures for billable supplemental services related to USA's contract to operate the Avalon water utility, sewer utility and storm water system increased \$0.1 million;

- Costs associated with Middlesex's Right of Way clearing program increased \$0.1 million; and
- Operation and maintenance expenses for all other categories increased \$0.3 million.

Depreciation

Depreciation expense for the three months ended September 30, 2014 increased \$0.1 million from the same period in 2013 due to a higher level of utility plant in service.

Other Taxes

Other taxes for the three months ended September 30, 2014 increased \$0.1 million from the same period in 2013, primarily due to higher revenue related taxes on higher taxable revenues in our Middlesex system.

Other Income, net

Other Income, net for the three months ended September 30, 2014 was consistent with the same period in 2013.

Interest Charges

Interest charges for the three months ended September 30, 2014 were consistent with the same period in 2013.

Income Taxes

Income taxes for the three months ended September 30, 2014 increased \$0.4 million from the same period in 2013, primarily due to increased operating income in 2014 as compared to 2013.

Net Income and Earnings Per Share

Net income for the three months ended September 30, 2014 increased \$1.0 million from the same period in 2013. Basic and diluted earnings per share were \$0.42 and \$0.36 for the three months ended September 30, 2014 and 2013, respectively.

Results of Operations – Nine Months Ended September 30, 2014

	(In Thousands)					
	Nine Months Ended September 30, 2014			2013		
	Regulated	Non-Regulated	Total	Regulated	Non-Regulated	Total
Revenues	\$78,547	\$ 10,485	\$89,032	\$76,906	\$ 10,518	\$87,424
Operations and maintenance expenses	36,624	8,333	44,957	37,184	8,514	45,698
Depreciation expense	8,394	138	8,532	8,070	135	8,205
Other taxes	8,944	266	9,210	8,953	262	9,215
Operating income	24,585	1,748	26,333	22,699	1,607	24,306
Other income, net	196	(6)	190	333	—	333
Interest expense	4,066	68	4,134	4,162	72	4,234
Income taxes	6,962	773	7,735	6,222	718	6,940
Net income	\$13,753	\$ 901	\$14,654	\$12,648	\$ 817	\$13,465

Index

Operating Revenues

Operating revenues for the nine months ended September 30, 2014 increased \$1.6 million from the same period in 2013. This increase was primarily related to the following factors:

- Middlesex System revenues decreased \$0.8 million, primarily due to the following:
 - o Revenues from GMS customers were consistent with the same period in 2013, primarily due to decreased GMS customer demand (approximately \$0.8 million) as a result of unfavorable weather and Hess Corporation ceasing its oil refining operations at its Port Reading, New Jersey facility in February 2013. This was offset by the BPU-approved rate increase implemented in July 2014 (approximately \$0.8 million); and
 - o Contract Sales to Municipalities decreased by \$0.8 million primarily due to the loss of the Borough of Sayreville, New Jersey as a wholesale customer in August 2013 (\$1.2 million) partially offset by the BPU-approved rate increase implemented in July 2014 and by higher demand from customers (collectively \$0.4 million);
- Tidewater System revenues increased \$1.9 million, primarily due to the following:
 - o Increased fees for new customer connections to our water system;
 - o The February 2014 implementation of a DEPSC-approved 6.5% interim base rate increase, net of the partial deferral of the interim base rate increase (see Note 2, *Rate and Regulatory Matters – Tidewater*); and
 - o Higher customer demand;
- TESI's revenues increased \$0.4 million, primarily due to service revenues from the customers of the acquired Plantations wastewater system, which TESI began serving in October 2013; and
- USA-PA's revenues increased \$0.1 million, primarily from scheduled increases in the fixed fees paid under contract with the City of Perth Amboy.

Operation and Maintenance Expense

Operation and maintenance expenses for the nine months ended September 30, 2014 decreased \$0.7 million, primarily related to the following factors:

- Employee benefit expenses decreased \$2.1 million due primarily to lower postretirement employee benefit plan costs resulting from improved performance in 2013 on our investment of retirement plan funds and a higher discount rate used for the actuarially determined 2014 expense;
- Variable production costs decreased \$0.3 million primarily due to lower customer demand and higher water quality in our Middlesex System;
 - Expenditures for billable supplemental services related to USA's Avalon contract decreased \$0.3 million;
- Severe winter weather resulted in higher water main break costs of \$0.5 million in our Middlesex and Pinelands Systems;
- Inspection, maintenance and repair services increased \$0.4 million at Middlesex's production and transmission and distribution facilities;
- Labor costs increased \$0.7 million, primarily related to higher overtime resulting from severe winter weather in our Middlesex System; and

Operation and maintenance expenses for all other categories increased \$0.4 million.

Depreciation

Depreciation expense for the nine months ended September 30, 2014 increased \$0.3 million from the same period in 2013 due to a higher level of utility plant in service.

Index

Other Taxes

Other taxes for the nine months ended September 30, 2014 were consistent with the same period in 2013, primarily due to lower revenue related taxes on lower taxable revenues in our Middlesex system offset by higher payroll taxes.

Other Income, net

Other Income, net for the nine months ended September 30, 2014 decreased \$0.1 million from the same period in 2013, primarily due to business development costs at our TESI subsidiary.

Interest Charges

Interest charges for the nine months ended September 30, 2014 decreased \$0.1 million from the same period in 2013, primarily due to lower average interest rates on long-term debt and lower average long-term debt outstanding.

Income Taxes

Income taxes for the nine months ended September 30, 2014 increased \$0.8 million from the same period in 2013, primarily due to increased operating income in 2014 as compared to 2013 and a higher effective tax rate, resulting from Middlesex's subsidiaries who pay state income taxes contributing a higher percentage of 2014 consolidated pre-tax income.

Net Income and Earnings Per Share

Net income for the nine months ended September 30, 2014 increased \$1.2 million from the same period in 2013. Basic earnings per share were \$0.91 and \$0.84 for the nine months ended September 30, 2014 and 2013, respectively. Diluted earnings per share were \$0.90 and \$0.83 for the nine months ended September 30, 2014 and 2013, 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 customer growth. The effect of those factors on net income is discussed in “Results of Operations.”

For the nine months ended September 30, 2014, cash flows from operating activities increased \$1.3 million to \$22.4 million. The increase in cash flows from operating activities primarily resulted from the timing of income tax and vendor payments. The \$22.4 million of net cash flow from operations enabled us to fund all of our utility plant expenditures internally for the period.

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 our Amended and Restated Dividend Reinvestment and Common Stock Purchase Plan (DRP) and common stock offerings. See below for a more detailed discussion regarding the funding of our capital program.

The capital investment program for 2014 is currently estimated to be \$26.6 million. Through September 30, 2014, we have expended \$15.8 million and expect to incur approximately \$10.8 million for capital projects for the remainder of 2014.

We currently project that we may expend approximately \$59.0 million for capital projects in 2015 and 2016. The actual amount and timing of capital expenditures is dependent on project scheduling and refinement of engineering estimates for certain capital projects.

Index

To fund our capital program for the remainder of 2014, we plan on utilizing:

Internally generated funds

Proceeds from the sale of common stock through the DRP

Funds available and held in trust under existing New Jersey State Revolving Fund (SRF) loans (currently, \$2.3 million). SRF programs provide low cost financing for projects that meet certain water quality and system improvement benchmarks.

Short-term borrowings, if necessary, through \$60.0 million of available lines of credit with several financial institutions. As of September 30, 2014, the outstanding borrowings under these credit lines were \$30.5 million.

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

Index

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 \$5.6 million of the current portion of 40 existing long-term debt instruments will mature. Applying a hypothetical change in the rate of interest charged by 10% 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 price increases through 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 postretirement benefit plan assets are exposed to fluctuating market prices of debt and equity securities. Changes to the Company's postretirement benefit plan assets' value can impact the Company's postretirement benefit plan expense, funded status and future minimum funding requirements. Our risk is reduced through our ability to recover postretirement benefit plan costs through rates.

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.

Index

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, 2013.

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.

23

Index

Item 6. Exhibits

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: November 6, 2014