Lincoln Group LLC

Financial and Business Due Diligence of The Milford Water Company Interim Report

July 12, 2017

Key Findings – Overall

- Most compelling argument for proposed Transaction is Town's desire to control quality and management of operations to insure consistency and adequate investment in CAPEX
  - Low level of CAPEX, management issues, and weather led to most recent problem at MWC
  - *If decision is to move forward, Milford should commit itself to provide effective management and adequate CAPEX to insure that quality and consistency objectives are met; otherwise, there is increased risks of potential for recurrence of problems*
- Review of similar takeovers of investor owned utilities by local governments question economic rationale *(Analysis Group, Jan 2017)*
  - Several towns have failed to deliver rate benefits promised to customers
  - Transactions have placed immediate and substantial financial burdens on customers
  - No sound basis to report that elimination of profits and taxes has led to lower rates
  - Local governments tend to substantially underestimate acquisition costs
- Level yearly debt service (principal and interest) of $3.4M for thirty years has a major impact on economics of takeover as compared to private ownership
  - Comparative analysis shows debt service increases total costs to run operations vs MWC
  - There is a compelling economic rationale for owning MWC after debt has been paid back

Key Findings – Overall

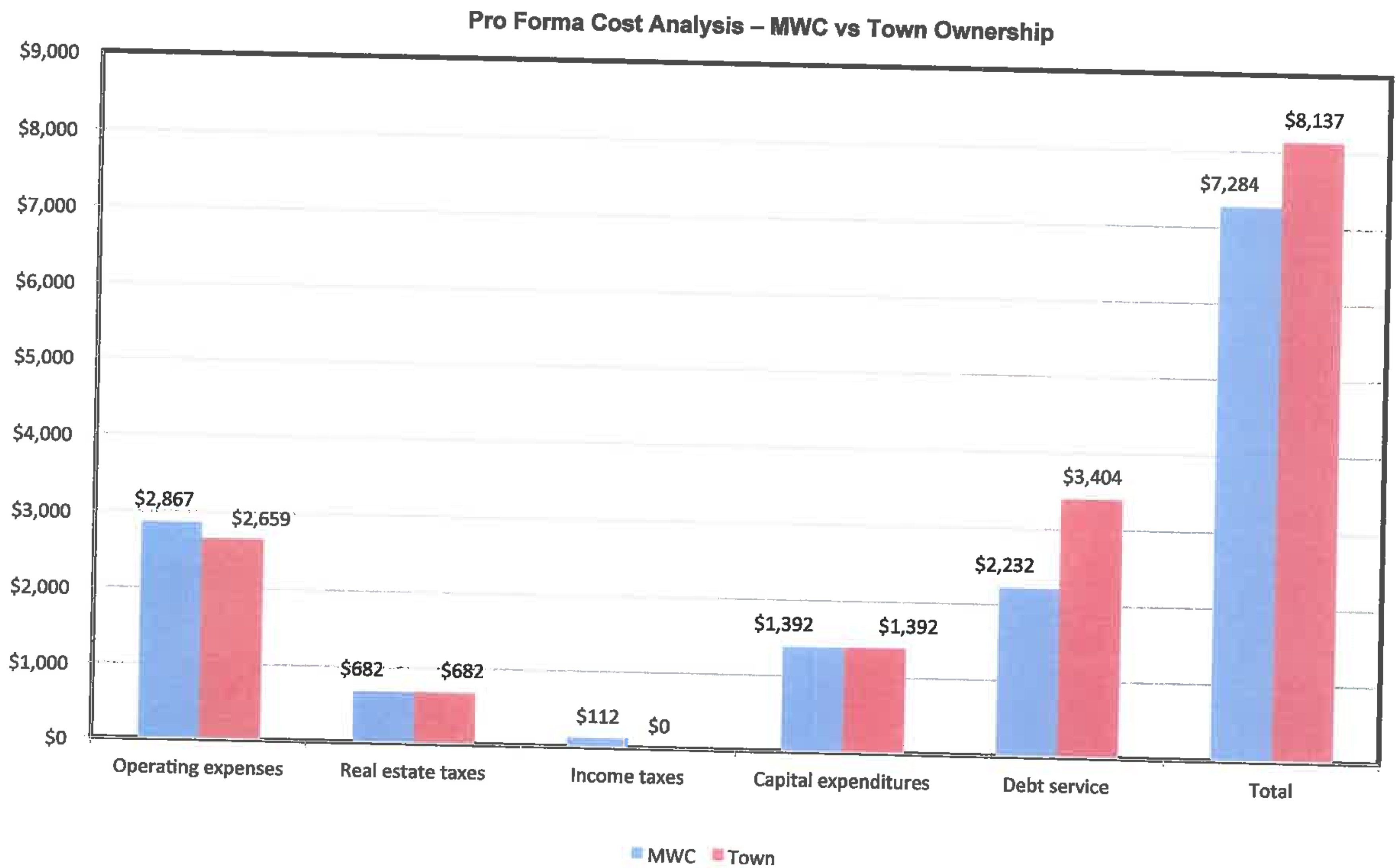
- Historical MWC audited financial statements point to marginal returns for current ownership, limited dividends, low federal taxes paid, and re-investment of profits back into business
  - Owners could obtain equal or higher levels of return from passive investments
  - Financial analysis of MWC shows that the business does NOT produce large income for Town to acquire
- Acquisition for $63M with 2.5% rate increase in 2018 will not fund operations sufficiently
  - Will require immediate additional source of cash to fund CAPEX
  - $3.4M payments ($63M Debt) increases costs by $850K versus private ownership
- Incremental $10M debt to finance funding of CAPEX (per Russell Consulting) without substantial rate increase will be subject to debt service coverage requirement of greater than 1.25X of free cashflow
  - Ratio immediately following acquisition with $63M bond will be approximately 1.05X
  - 2.5% rate increases per year will not provide adequate cashflow for 1.25X ratio over time
  - Even if additional debt can be found to fund $10M, the resulting Enterprise will struggle financially
  - Consequence of too much debt will be to limit CAPEX expenditures which will increase operating risks
- Need to consider alternative ways to fund Enterprise and provide for healthy financial platform
  - Potential ways to "re-balance" the new Enterprise including a substantial rate increase in excess of 2.5%
  - Consider renegotiating purchase price based on financial constraints concerning true affordability

Key Findings - Financial

- Comparative financial and economic review of Transaction reveals higher costs of operations (on a pro forma basis for 2018) for Town versus independent ownership
  - Debt burden expense of Enterprise versus MWC is $1.2M per year ($3.4M vs $2.2M)
  - Overall expense variance between Enterprise and MWC is $850K per year
  - Higher cost places Enterprise at an immediate disadvantage versus MWC on a comparative basis
  - Rate increase by MWC of 20-25% will provide it with adequate cash flow to insure sustainable financial strength without need for sizeable additional debt
  - If Town only increases rate by 2.5% in 2018, Enterprise will be saddled with additional debt payments to pay for CAPEX and not generate sufficient free cashflow for several years – pushing off problem to the future or until a sizeable rate increase is implemented

- Debt service burden is the single most significant difference and most sensitive cost issue
  - MWC incurred debt to fund the new processing plant for approximately $20M; vs $63M for Enterprise – extra borrowing does not add anything for rate payers until debt paid off
  - Renegotiating purchase price to or extending amortization to 40 years would lower costs and potentially "re-balance" relative cost economics and set Enterprise on firmer footing

Key Findings - Financial



Key Findings - Financial

- The Town can obtain initial financing for $63M with a substantial premium which will reduce initial financing to $50M over 30 yrs.
  - Bond underwriters will require due diligence which will investigate immediate need for cash flow
  - Initial financing for $63M will likely include restrictions on additional debt
- Town may be able to obtain financing for 40 year amortization which could reduce yearly debt burden, but will require special legislation and process would not start until later this year
  - 40 year amortization is considered riskier than 30 and will likely include higher interest rate
- All financing for initial or incremental debt will be under review and scrutiny of rating agencies
  - Bond for $63M will include covenants which will stipulate minimum threshold for cashflow
  - Lenders DO NOT finance losses or lack of sufficient operating cashflow as a general rule
- Rating agencies will likely consider several important factors when evaluating new Enterprise
  - Most important factors are appropriate coverage ratios to insure that debt service will be paid
  - The "number of days cash on hand" is important metric in case of emergencies or adverse weather
  - State and Federal compliance with regulations will require system is sufficiently funded

Key Findings – Business and Operations

- There is an effective argument for Town ownership on the basis of control over consistency and adequate investment in CAPEX; get rid of lumpy rate increases which result from current ownership
  - Rate increases set on yearly basis which mitigates shock of larger increases (not always 2.5%)
  - Objectives and goals can be set over longer term and consider increasing service levels
  - MWC currently deals with lag period and uncertainty over rate increases with DPU - difficulty for planning effectively
- Business Risk can be defined in two separate categories:
  - External Risk includes factors for which the company has no control
  - Internal Risk includes factors for which the Town/company has control
- External Risk factors
  - Weather is a major determinant of yearly usage and potential for health problems
  - Water source risks – pollution of Charles River, groundwater contamination, availability, etc.
- Internal Risk Factors
  - Ability to manage operations effectively with high quality staff
  - Governance of Enterprise and ability to oversee the best interests of the rate payers
  - Ability to plan for and assess long term needs and provide CAPEX – i.e. Water Source Development

Key Findings – Business and Operations

- External Risk Factors
  - Usage levels either Up or Down
    - Increase in usage will require higher levels of CAPEX and new Water Sources
    - Decrease in usage will require means to cover costs through higher rate increases
  - Water Sources could become be less productive requiring more CAPEX
  - Terrorism, pollution, or contamination of water supply, physical plant, etc.
  - Ownership of MWC by large conglomerate where cost of debt passed along

- Internal Risk Factors
  - Management transition between new manager and existing manager
  - Transition of existing staff to new ownership and compensation system
  - Fund adequately CAPEX for existing (Water Sources) and potential new service levels
  - Governance of Enterprise which provides for good management practices (GMP)

Preliminary Recommendations

- Assuming Milford is inclined to make acquisition, there are several alternative mitigating options (either taken singly or together) which can enable the Enterprise to operate more effectively from a financial and business perspective
  - Increase rates for 2018 by 15-20% to provide a solid cashflow "rebalancing"
  - Stagger rate increases over two years while deferring CAPEX expenditures into 2019
  - Increase rates thereafter based on needs for CAPEX and service levels desired
  - Aggressively pursue 40 year amortization to increase yearly cashflow
  - Provide an immediate injection of cash to assist with rebalancing and transition costs
  - Aggressively pursue State Revolving Fund for high priority CAPEX at 0% interest
  - Renegotiate the purchase price and lessen yearly debt burden (less likely)
  - Stay flexible with respect to rate increases which can be more in some years, less in others
- In addition, to lessen financial and business risk, there are certain actions which can help to mitigate future risks
  - Set up effective governance structure for Enterprise which includes outside member
  - Provide Financial oversight of Enterprise from Finance Director and Treasurer

Next Steps

- Finish risk analysis of transaction
- Continue to evaluate sensitivity analysis
- Develop alternative scenarios of water usage
- Complete analysis of rate increase required
- Complete analysis of cost for existing employees
- Complete analysis of CAPEX
- Evaluate requirements for start-up capital

Appendix

- Don Wallroth – Partner
- Peter Monson – Consultant
- Nancy Parrillo – Consultant

Don Wallroth – Managing Partner

Currently:

Executive Chairman – Synovia Solutions – SaaS Software company $30M revenue

CEO – Lincoln Energy Corporation – Family owned Energy Business

Previously:

CEO – Everyday Solutions, Inc. – Software company in Acton MA

CFO – Molecular Insight Pharmaceuticals (MIPI - NASDAQ), Brown Rudnick, PSDI, etc.

COO – Transition Systems (NEMC), GoldK.com, Avery Dennison New Ventures Group

Partner – Accenture, Arthur Andersen Worldwide

Partner – Arthur D. Little, Inc. – Lead partner in charge of Financial Consulting

Other: Prior Experience as Member of FinCom for Town of Lincoln, MA

Education: MBA Columbia University, BSEE George Washington University

Nancy Parrillo - Consultant

Currently **:**

Consultant – Lincoln Group LLC

Senior Manager – Finance for the Providence Water Supply Board

Previously:

CFO – RI Turnpike & Bridge Authority – quasi state agency

CFO – Mass. Water Pollution Abatement Trust (State Revolving Fund)

CFO – South Essex Sewerage District – regional wastewater treatment facility , Salem, MA

Principal – Tatum LLC Financial consulting firm

Peter Monson - Consultant

- ***Currently:***
- Consultant – Lincoln Group LLC
- ***Previously:***
- CFO Engagement Partner – Tatum
- CFO – Psychemedics Corporation (PMD), Bet Systems, Gamma International, Nathan/Tyler
- VP Finance – Molecular Insight Pharmaceuticals (MIPI), Cellular One
- Auditor – Coopers & Lybrand
- ***Other:***
- Certified Public Accountant – Commonwealth of Massachusetts
- Massachusetts Society of Certified Public Accountants (MSCPA)
- American Institute of Certified Public Accountants (AICPA)