STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Docket No. DW 19-084

Pennichuck Water Works, Inc.
Rate Proceeding

SUPPLEMENTAL DIRECT TESTIMONY OF LARRY D. GOODHUE

August 21, 2019

I. <u>INTRODUCTION</u>

Q. Please state your name, address and position with Pennichuck Water Works, Inc., as well as its corporate Parent, Pennichuck Corporation?

A. My name is Larry D. Goodhue. My business address is 25 Manchester Street, Merrimack, New Hampshire. I am the Chief Executive Officer of Pennichuck Water Works, Inc. ("PWW" or "Company"). I am also the Chief Executive Officer of Pennichuck Corporation ("Penn Corp"), which is the corporate parent of PWW. I have been employed in the CEO capacity since November 6, 2015. Prior to serving as CEO, I served as Chief Financial Officer of Penn Corp and PWW. In addition to holding the CEO title for both PWW and Penn Corp, I have retained the title of CFO for both entities, as well as Treasurer for the two companies, as well as the other subsidiaries of Penn Corp.

Q. Have you filed testimony in this docket?

A. Yes.

II. BOND RATING REPORTS

Q. Did the Commission's Staff contact you and request that you provide supplemental information concerning PWW's bond rating?

A. Yes.

Q. Please explain.

A. In my pre-filed direct testimony, I discussed at length the effect the certainty of cash flow was having on the Company's bond rating as well as the preference of PWW's underwriters that PWW's cash flow be sufficient to cover expenses. See pages 14 through 23. Staff contacted the Company and requested additional ratings data, which is attached.

Q. Please identify the attachments.

A. The attachments comprise:

- 2012 Moody's Credit Analysis – prior to the January 25, 2012 acquisition of Pennichuck Corporation by the City of Nashua, all of Pennichuck Water Works tax-exempt and taxable bonds, as well as one note payable, were rated by Moody's

- 2014 Standard & Poor's Ratings Report – this rating report was the first one issued by S&P, with PWW's 2014 bond issuance of new tax-exempt and taxable bonds, as well as refinanced bonds issued originally prior to 2012

- 2015 Standard & Poor's Ratings Report – this rating report was issued related to the 2015 issuance of new and refinanced tax-exempt and taxable bonds

- 2018 Standard & Poor's Ratings Report – this rating report was issued related to the 2018 issuance of tax-exempt and taxable bonds

- 2019 Standard & Poor's Ratings Report - – this rating report was issued related to the 2019 issuance of tax-exempt and taxable bonds

- American Association of Individual Investors article: *How Credit Ratings Affect Bond Valuations*

Q. Please explain the attachments.

A. The 2012 Moody's Credit Analysis is a legacy report coming out of Docket No. DW 11-026, which was the proceeding where the Commission approved the City of Nashua's acquisition of Penn Corp, PWW's parent. This report is reflective of the legacy issued bonds (originally issued as issuances in 1997 or 2005 thru 2009, as series 1997, 2005 series A or series 2005A, 2005B, or 2005C) which PWW refinanced in 2014 and 2015. All of these legacy bonds were issued when the Penn Corp and its subsidiaries were traditional, publicly-traded investor owned utilities, with a typical debt/equity ratio. All of these legacy bonds were also issued as balloon maturity bonds, as would be typical in those circumstances and capital structure. This report shows Moody's rating of PWW post-acquisition but prior to rate modifications that were implemented in PWW's subsequent rate cases. The rating of Baa3 in Moody's is equivalent to an S&P rating of BBB-, as the below chart illustrates.

Credit Rating Scales by Agency, Long-Term

Moody's	S&P	Fitch	
Aaa	AAA	AAA	Prime
Aa1	AA+	AA+	High grade
Aa2	AA	AA	
Aa3	AA-	AA-	
A1	A+	A+	Upper medium grade
A2	A	A	
A3	A-	A-	
Baa1	BBB+	BBB+	Lower medium grade
Baa2	BBB	BBB	
Baa3	BBB-	BBB-	
Ba1	BB+	BB+	Non-investment grade speculative
Ba2	BB	BB	
Ba3	BB-	BB-	
B1	B+	B+	Highly speculative
B2	B	B	
B3	B-	B-	
Caa1	CCC+	CCC	Substantial risk
Caa2	CCC		Extremely speculative
Caa3	CCC-		Default imminent with little prospect for recovery
Ca	CC	CC	
	C	C	
C	D	D	In default
/			
/			

"Junk"

WOLFSTREET.com

Source: https://wolfstreet.com/credit-rating-scales-by-moodys-sp-and-fitch/

The chart shows the fact that movements in PWW's rate structure have resulted in PWW being upgraded by 4 steps in the rating scale, from Baa3/BBB- to its current rating of A+ (Moody's equivalent of A1). This positive movement in the Company's bond rating translates into two things: better coupon rates, and better demand for our bonds (which also translates into better coupon rates, as increased demand breeds lower coupon rates). Better coupon rates and better demand for the bonds facilitates two things: access to needed funds to pay for ongoing capital projects and infrastructure replacement, and lower cost of interest for those funds which are passed along to the Company's ratepayers.

The November 2014 Standard & Poor's Ratings Report was issued as an element of PWW's issuance of new money bonds, as well as the refinance of a portion of the Company's pre-2012 legacy bonds, from balloon maturity obligations to fully amortizing obligations. See Attachment LDG-1, pages 6-10. This was the first bond rating the Company received from S&P, and the first rating to analyze and assess the Company's overall credit worthiness post-acquisition, reflecting the modified rate structure approved for the Company as a part of Docket No. DW 11-026. This rating report moved the Company from its legacy rating of Baa3/BBB- to an A rated company (with a stable outlook); representing a 4-step upwards movement in its credit rating. Two key take-aways in this report are included in the "Outlook" section of the report on page 3. In this section, S&P indicates that it did not expect to raise the Company's credit rating within the 2-year outlook period, but also cautioned that it could lower the Company's credit rating if the rate setting process for the Company is not amply anticipated (and therefor, properly constructed to insure effective coverage of bond service costs, as well as ongoing operating expenses).

The August 2015 Standard & Poor's Ratings Report was issued as an element of PWW's issuance of new money bonds, as well as the refinance of the remainder of the Company's pre-2012 legacy bonds, from balloon maturity obligations to fully amortizing obligations. This report affirmed the credit rating and outlook by S&P in the 2014 report, and was issued prior to the Company's request in Docket No. DW 16-806 for approval to modify its rate structure in light of cash flow considerations the Company asserted in that case relating to the coverage of the Company's fixed obligations under the City Bond Fixed Revenue Requirement ("CBFRR"), and Debt Service Revenue Requirement ("DSRR") portions of its allowed revenues, as well as its ongoing necessary operating expenses. S&P's comments in the "Outlook" section of this report are nearly identical to those issued in the 2014 report. See Attachment LDG-1, pages 11-15.

The March 2018 Standard & Poor's Ratings Report was issued as an element of PWW's issuance of new money bonds to fund the projects completed and used and useful in 2017, under the Company's newly approved and enacted Qualified Capital Project Adjustment Charge ("QCPAC") program, as approved in Docket No. DW 16-806. See Attachment LDG-1, pages 16-21. It is important to note that the fundamental changes in the rate structure for PWW from that case resulted in an enhancement to the Company's credit rating, including:

(1) the designation of revenues into the three component buckets (CBFRR, DSRR and OERR),
(2) the usage of a 5-year trailing average for test year revenues,
(3) the implementation of the QCPAC, and
(4) the bifurcation of the RSF fund into component parts to support the buckets of allowed revenues.

The major take-away from this report is once again included in the "Outlook" section of the report on page 4, where they notate the positive impact of the new rate structure, and its potential future impact on the Company's overall credit make-up. The overall result of this report was another 1 step upgrade in the Company's credit rating from A to A+ (again with a stable outlook).

The March 2019 Standard & Poor's Ratings Report was issued as an element of PWW's issuance of new money bonds to fund the projects completed and used and useful in 2018, under the Company's QCPAC program. See Attachment LDG-1, pages 22-27. This report maintained the Company's A+ rating but changed the outlook from stable to negative. If you refer to the "Outlook" section of this report on page 5, you will notice that this indicates that there is a one-in-three chance that they could lower the Company's credit rating in the next two years, unless certain actions were taken by the Company in support of its overall ability to provide adequate cash flow coverage for its debt obligations and ongoing operating expenses. It also indicates that they could revise this outlook to a stable outlook once again, should the Company prevail in working the Commission to further modify its rate structure in a manner that will re-establish the Company's rate stabilization fund ("RSF") funds, and put elements in place to insure the stability of those funds going forward.

This is one of the critical bases for which the Company is requesting the implementation of the Material Operating Expense Surcharge ("MOES") in the current rate case, as it will eliminate a great deal of the regulatory lag that the Company experiences in covering its ongoing operating expenses, as they increase with inflation between rate cases, and as such, cause the Company to use its RSF funds to a great extent between rate cases. The usage of these RSF funds to this great extent, draws those funds down to levels below the "indenture-allowed levels," as cited in the report, and for which credit rating agencies look at as element of overall cash flow coverage and liquidity of the Company.

It is also important to note that lenders other than the credit rating agencies focus on the very same metrics when it comes to loaning money to PWW, or its sister subsidiaries Pennichuck East Utility, Inc. and Pittsfield Aqueduct Company, Inc., as well as the senior lender that provides the Working Capital Line of Credit to the consolidated group, through the parent company, Penn Corp.

And lastly, the Company has provided the American Association of Individual Investors article: *How Credit Ratings Affect Bond Valuations.* See Attachment LDG 28-40. This has been provided to provide a basis from which the Staff and the Commission can have a greater understanding of the overall impact that bond credit ratings have on bond valuations and the coupon rates associated with them. The most critical thing that a prospective bond investor is focused upon is the possibility of an issuer to default on the repayment of the bonds. The overall credit rating is important in this, but equally so, is the outlook given by the credit rating agency. Bond holders look at that outlook as a leading indicator of the future credit worthiness of the issuing company. The other important thing to take from this article is that there is a perceived or designated minimum credit rating for which most investors will accept to acquire bonds on the market. As a rule, "investment grade" bonds are the limit for which most investors and institutions will accept in purchasing bonds. This means that bonds issued with a credit rating of BBB/Baa or higher will garner market interest to be purchased, whereas bonds below that rating will most likely either not be saleable or will have a "default" interest rate attached to them (which would be very costly). The article also clearly describes the interplay between credit ratings and cost of interest. The higher the rating, the lower the cost of interest. Conversely, the lower the rating, the higher the cost of interest.

Q. Mr. Goodhue, does this conclude your testimony?

A. Yes, it does.