NORTHERN UTILITIES, INC.

DIRECT TESTIMONY

OF

TODD R. DIGGINS

AND

ANDRE J. FRANCOEUR

EXHIBIT TDAF-1

New Hampshire Public Utilities Commission

Docket No. DG 21-104

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SCHEDULES

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Todd R. Diggins. My business address is 6 Liberty Lane West, Hampton, New Hampshire 03842.

My name is Andre J. Francoeur. My business address is the same as Mr. Diggins.

Q. Mr. Diggins, what is your position and what are your responsibilities?

A. I am the Treasurer and Director of Finance for Unitil Service Corp. ("Unitil Service"), a subsidiary of Unitil Corporation ("Unitil Corp.") that provides managerial, financial, accounting, regulatory, engineering and information technology services to Unitil Corp.'s subsidiaries. I am also the Treasurer of Northern Utilities, Inc. ("Northern" or the "Company") and Unitil Corp.'s other utility subsidiaries. My responsibilities are primarily in the areas of financial planning and analyses, regulatory projects, treasury operations, investor relations, and insurance and loss control programs.

Q. Please describe your business and educational background.

A. I have over 20 years of professional experience in the utility industry focused within the finance, accounting and regulatory areas. I joined Unitil Service in 1998 as a Systems Financial Analyst. In 2004 I accepted a position within the Accounting Department as a General Accountant and was promoted to Corporate Accounting Manager in 2009. In 2018 I was promoted to Director of Finance and in 2020 became Treasurer and Director of Finance. I hold a Bachelor of Science degree from the University of New Hampshire, a Master's Degree of Science in Finance from Southern New Hampshire University, and a Master's of Global Business Administration from Southern New Hampshire University.

Q. Do you hold any professional licenses?

A. Yes, I am a Certified Public Accountant in the State of New Hampshire.

Q. Mr. Francoeur, what is your position and what are your responsibilities?

A. I am a Senior Financial Analyst for Unitil Service. My responsibilities are primarily in the areas of financial planning and analyses, regulatory projects, investor relations and treasury services.

Q. Please describe your business and educational background.

I have approximately five years of professional experience within the finance and accounting areas. I began working for Unitil Service in 2017 as a Financial Analyst and was promoted to Senior Financial Analyst in 2020. I graduated from the State University of New York at Plattsburgh, receiving magna cum laude recognition, with a Bachelor of Science degree. At this time I am also pursuing a Master's degree in Business Administration from the University of New Hampshire.

Q. Do you hold any professional licenses?

Yes, I am a Certified Management Accountant.

Q. Were both this testimony and exhibits prepared by one of you or under your direct supervision?

A. Yes, they were.

II. SUMMARY AND OVERVIEW OF TESTIMONY

Q. What is the purpose of this testimony?

A. The purpose of this testimony is to support the Company's proposed capital structure to be used for ratemaking purposes, support the Company's proposed long-term cost of debt rate and support the proposed rate of return on rate base. This testimony also discusses rating agency actions and other factors that may affect the Company's ability to efficiently access long-term capital.

Q. Please summarize the Company's proposed capital structure for ratemaking purposes.

A. As detailed on Schedules RevReq-6-1[1], the Company's proposed capital structure consists of 52.47% common equity and 47.53% long-term debt.

Q. Please summarize the Company's proposed cost of long-term debt.

A. The calculation of the cost of long-term debt for Northern is detailed on Schedule RevReq-6-4, which shows the weighted cost rate of 4.93% that was calculated by

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1 References in this testimony to "Schedule RevReq-6-1" are to the revenue requirement schedules sponsored by Northern witnesses Christopher J. Goulding and Daniel T. Nawazelski.

using the "Net Proceeds" methodology, consistent with New Hampshire Public Utility Commission precedent.

Q. Please summarize the Company's proposed overall Return on Rate Base.

A. As summarized on Schedule RevReq-6, the Company's proposed Return on Rate Base is 7.75%. The components of the proposed Return on Rate Base are discussed in greater detail later in this testimony.

III. CAPITAL STRUCTURE

Q. Please describe the Company's proposed capital structure for ratemaking purposes.

A. As detailed on Schedules RevReq-6-1, the Company's proposed capital structure consists of 52.47% common equity and 47.53% long-term debt. The proposed capital structure represents the five quarter average as of December 31, 2020.

Q. Does the proposed capital structure include short-term debt?

A. No, the proposed capital structure includes only sources of long-term capital that fund the permanent assets included in rate base. Those sources do not include short-term debt. The Company believes it is important to align the long-lived nature of utility assets with similarly termed capital. Short-term debt is used principally to fund seasonal working capital requirements and construction work in process ("CWIP"). As CWIP is not included in rate base, the short-term debt funding associated with CWIP should not be considered in the Company's regulatory capital structure for rate setting purposes. Short-term debt is not a permanent element of capital structure and should not be included in the regulatory cost of capital calculation.

Q. Please describe the Company's financing cycle.

A. The Company's funding is derived primarily from internally generated funds, which consist of net operating cash flows such as depreciation and amortization and deferred income taxes. Northern supplements internally generated funds through short-term borrowings under the Unitil Corp. Cash Pool, which is supported by bank borrowings under Unitil Corp.'s revolving credit facility. Over time, capital spending and debt retirements will result in short-term debt balances accumulating to levels that can be rolled into long-term financings. Under this financing cycle, short-term debt balances fall, and the capital structure's term is consistent with the long-term nature of utility assets.

Q. Please summarize the Company's recent long-term financings.

A. Please refer to Schedule TDAF-1 which shows the last 5 years of financing history at Northern and the frequency and size of that activity. Over the past 5 years, over $220 million of debt and equity capital has been invested into Northern. The Company is responsible for managing its capital structure and borrowing requirements in a prudent manner, and will continue to rely on long-term financings to better match the long-term nature of utility assets and recapitalizing short-term debt as appropriate.

Q. Is it appropriate to use a five quarter average capital structure?

A. A five quarter average is more representative of the Company's target capital structure going forward rather than the point in time capital structure as of December 31, 2020. The point in time capital structure at December 31, 2020 is less indicative of the Company's planned capital structure as a result of the timing of its most recent debt financing completed on September 15, 2020.

Q. How does the proposed capital structure compare to the proxy group?

A. The Company's proposed equity ratio of 52.47% is consistent with the peer group. Please reference Exhibit JC-11 in John Cochrane's testimony for the peer group's equity ratios over the last five years. Over the last five years the peer group's average equity ratio has been 52.93%.

Q. Please explain the primary goals the Company considers when managing its capital structure.

A. The primary goals to consider when managing the capital structure are to minimize the weighted average cost of capital, maintain sufficient equity funding to support the Company's balance sheet and creditworthiness, and provide financial flexibility. Capital structure is a measure of financial risk. Debt typically carries a lower cost than equity but has fixed payment obligations, unlike common equity. Therefore, although debt is less costly, higher debt leverage results in additional financial risk. The Company requires an equity ratio that appropriately manages its financial risk and supports its existing investment-grade credit ratings. Later in this testimony, credit and market factors that must be considered are discussed further.

Q. Does the capital structure impact the Cost of Equity?

A. Yes. Investors expect returns to be commensurate with the relative risk of an investment. Given the impact capital structure has on financing risk, it must be considered when determining the Cost of Equity.

Q. Do you believe the proposed capital structure for the Company is appropriate?

A. Yes. The proposed capital structure is consistent with the average equity ratio of the proxy group, and consistent with the industry tenet of matching the long-term nature of rate base assets with the appropriate sources of capital.

IV. COST OF DEBT

Q. What cost of debt has the Company requested in this proceeding?

A. The calculation of the cost of long-term debt for Northern is detailed on Schedule RevReq-6-4, which shows the weighted cost rate of 4.93%.

Q. Please discuss your analysis of the Company's proposed Cost of Debt.

A. Please refer to Schedule TDAF-2 which tests the reasonableness of the proposed cost of debt. This schedule compares the Company's cost of debt, excluding transaction costs, to the Moody's Bond Yield average for both A-Rated Utilities and BAA-Rated Utilities as of the offering dates of the Company's outstanding debt. Given that the Company's cost of debt rate is consistent with the range of these Utility Bond Indices, we conclude that the Company's proposed cost of debt is appropriate and reasonable.

V. RETURN ON RATE BASE

Q. Please summarize the Company's proposed rate of return on rate base.

A. As summarized on Schedule RevReq-6, the Company's proposed return on rate base is 7.75%. This is the sum of the weighted cost of common equity and the cost of debt.

Q. Please describe how the cost of capital is weighted.

A. The cost of capital is weighted by the Company's proposed capital structure, which is described above.

Q. Please summarize the costs of the various capital components.

A. The Company is proposing a Return on Equity of 10.30 percent, which is toward the lower end of the range recommended and supported in the prefiled testimony of the Company's expert, John Cochrane. The Company proposes a Return on Equity at the lower end of the recommended range to mitigate rate effects on customers. The proposed cost of debt of 4.93% is calculated consistent with New Hampshire Public Utilities Commission precedent.

Q. Do you believe the proposed rate of return on rate base is appropriate?

A. Yes, for the reasons described in this testimony and the testimonies of Mr. Hevert, Messrs. Goulding and Nawazelski and Mr. Cochrane, the Company's proposed rate of return on rate base is reasonable and appropriate.

VI. CREDIT RATINGS AND OTHER MARKET CONSIDERATIONS

Q. Please discuss the Company's current credit ratings.

A. Northern has an issuer rating of BBB+ from Standard & Poor's ("S&P") rating agency and an issuer rating of Baa1 from Moody's. Both ratings are considered "investment-grade." The S&P credit rating is determined based on Unitil Corp's entire suite of subsidiaries while the Moody's credit rating is specific to Northern.

Q. Are the Company's credit ratings consistent with the peer group?

A. Yes. The table below compares the Company's credit ratings to those of the holding companies of the utility peer group introduced in the testimony of Mr. Cochrane. The results reflect that the Company's credit ratings are largely consistent with its peers.

Table 1: Credit Rating Benchmarking

PEER GROUP CREDIT RATINGS				
	(1)	(2)	(3)	(4)
LINE NO.	COMPANY	TICKER	S&P	Moody's
1	Atmos Energy Corporation	ATO	A-	A1
2	Chesapeake Utilities	CPK		
3	NiSource Inc.	NI	BBB+	Baa2
4	New Jersey Resources	NJR	-	A1
5	Northwest Natural	NWN	A+	Baa1
6	ONE Gas, Inc.	OGS	BBB+	A3
7	South Jersey Industries, Inc.	SJI	BBB	A3
8	Southwest Gas Holdings, Inc.	SWX	BBB+	Baa1
9	Spire Inc.	SR	A-	Baa2
10	Northern Utilities, Inc.	UTL	BBB+	Baa1

Q. Have there been any recent changes to the Company's credit ratings?

A. Yes. S&P revised Unitil Corp.'s outlook from stable to negative. Please refer to Schedule TDAF-3 for a publication of the announcement on November 5, 2020.

Q. Please summarize the reason for the outlook change and the potential implications.

A. S&P cited Unitil Corp.'s smaller size relative to peers, weaker financial measures expected in the future as a result of deteriorating economic conditions related to the pandemic and warmer than normal winter weather in 2020. S&P stated that Unitil's sales margins have become more uncertain without decoupled revenue mechanisms in place. Historically, credit rating agencies are quick to respond to negative events or elevated risk, but slower to act on positive events. S&P indicated it may downgrade the Company if the funds from operations to debt ratio doesn't improve and consistently achieve at least 16%.

A credit downgrade would increase the perceived investment risk of Unitil Corp. to current and prospective investors, and likely increase the Company's cost of capital. The ability to attract competitive sources of capital, especially in times of economic stress, is critical to Northern continuing to provide exceptional service to the communities it serves at competitive rates. Refinancing maturing debt at desirable terms is determined by the strength of our credit profile, which is directly impacted by regulatory outcomes.

Q. When considering the Company's proposed capital structure are there any other significant factors that should be considered?

A. Yes. Credit rating agencies make a variety of adjustments to the financial statements when determining credit metrics. The most significant adjustment is the inclusion of Unitil Corp.'s retirement benefit obligations as imputed debt. Imputed debt unfavorably impacts solvency metrics that compare cash flow to debt. Schedule TDAF-4 shows the recent history of the underfunded retirement benefit obligations as well as the discount rate used to determine the benefit obligation. As of December 31, 2020 the imputed debt for these obligations was approximately $129 million. This is equal to about 22% of Unitil Corp.'s total debt on the books as of December 31, 2020, reflecting the materiality of this credit rating adjustment. Under the S&P methodology, the underfunded obligation is lowered by the federal income tax when calculating the imputed debt. The impact of the lower federal income tax rate, as a result of the Tax Cuts and Jobs Act of 2017, had the impact of increasing the level of imputed debt. Using the

S&P methodology, the imputed debt for retirement benefit obligations has increased over $30 million from 2016 to 2020 and is largely due to the lower federal tax rate and a lower discount rate. To maintain investment-grade credit metrics, Unitil Corp. (and its subsidiaries, including Northern) must maintain strong equity ratios to offset the retirement benefit debt imputed by credit rating agencies.

Q. Please describe the Company's plan to support its credit ratings.

A. The Company has increased its target equity ratio range in order to strengthen its balance sheet and offset the impact of the imputed debt. Secondly, the Company has proposed a decoupled revenue mechanism in this docket[2] which is credit supportive as a result of more stable revenues. Finally, by implementing multiyear rate plans the Company can recover capital costs in a timelier fashion, thereby reducing the volatility of financial metrics over time. The Company's proposed multiyear rate plan in this filing is included in the joint testimony of Messrs. Christopher J. Goulding and Daniel T. Nawazelski. The importance of a multiyear rate plan similar to what the Commission approved in Northern's prior base rate case proceedings cannot be overstated. A multiyear rate plan supports the Company's investment in the distribution system, helps maintain and stabilize its financial health, and provides a reasonable opportunity to earn its authorized rate of return without the need to file frequent rate cases

[2] See generally Direct Testimony of Timothy S. Lyons.

Q. Are there other market considerations you would like to address?

A. Yes. Unitil Corp.'s small size relative to our utility peers poses challenges to the Company's credit ratings, equity investors and the raising of equity capital.

Q. Please outline the small size risk on credit ratings.

A. As noted above, both S&P and Moody's consider Unitil Corp.'s smaller relative size and scale to be a credit challenge. Specifically, S&P considers Unitil Corp.'s smaller relative customer base as a risk to the Company's business profile. Similarly, Moody's sees Unitil Corp.'s small size and scale as a "credit challenge". Please see Schedule TDAF-5, and Schedule TDAF-6, for the most recent credit reports published by S&P and Moody's, respectively.

Q. Please demonstrate Unitil Corp.'s size relative to its utility peers.

A. The table below illustrates the market capitalization of Unitil Corp. and its peer utilities. Unitil Corp. has the smallest market capitalization of the utility peer group. Unitil Corp.'s market capitalization is less than half the size of Northwest Natural, the smallest company by market capitalization in the peer group.

Table 2: Market Capitalization Benchmarking

Average Daily Capitalization - 90 Day Average ($ millions)				
Line No.	COMPANY	TICKER		MARKET CAPITALIZATION
1	Atmos Energy Corporation	ATO	$	12,705
2	NiSource Inc.	NI	$	9,658
3	ONE Gas, Inc.	OGS	$	4,037
4	New Jersey Resources	NJR	$	4,010
5	Southwest Gas Holdings, Inc.	SWX	$	3,915
6	Spire Inc.	SR	$	3,800
7	South Jersey Industries, Inc.	SJI	$	2,576
8	Chesapeake Utilities	CPK	$	2,046
9	Northwest Natural	NWN	$	1,630
10	Unitil Corporation	UTL	$	770

Data as of 06/30/2021

Q. Explain how the smaller relative size increases risk to shareholders.

A. Unitil Corp.'s relatively small market capitalization generally results in lower trading volumes and less liquidity due to fewer shares outstanding. Market liquidity risk is the risk that an investor cannot quickly buy or sell an asset without impacting the market price. Put another way, investors who would like to materially increase or decrease their positon in a smaller company have greater difficulty doing so without causing price fluctuations. The table below further illustrates that Unitil Corp.'s daily trading volume is notably and consistently lower than the utility peer group average.

Table 3: Average Daily Volume Benchmarking

Average Daily Volume to Average Daily Shares Outstanding						
DESCRIPTION	**2016**	**2017**	**2018**	**2019**	**2020**	**Avg.**
Unitil Corporation	0.32%	0.31%	0.32%	0.33%	0.51%	0.36%
Peer Group Mean	0.60%	0.45%	0.57%	0.55%	0.72%	0.58%
Peer Group Median	0.56%	0.42%	0.50%	0.50%	0.66%	0.53%
Source: S&P Global Market Intelligence						

Q. Is lower liquidity a concern for some investors?

A. Yes, liquidity is an important consideration to institutional investors as they tend to buy and sell large equity positions of a company. The term "institutional investors" refers to large organizations that make substantial investments, such as banks, hedge funds, pension funds, investment advisors, etc. These investors usually require a minimum dollar amount to invest in a particular asset in order to efficiently manage their portfolio. As mentioned previously, these companies could face difficulty acquiring or divesting a position without adversely affecting the market price of the shares.

Q. Can institutional investors be a benefit to a company like Unitil Corp.?

A. Yes, capital intensive companies such as Northern, and its parent Unitil Corp., can benefit from institutional investors because they provide an efficient source of capital due to the amount of resources they are able to invest. Institutional investors typically account for 70% to 80% of utility share ownership. In order to attract and maintain institutional ownership the expected return must compensate investors for the associated risk of the investment. Specifically, all else held constant, the expected return associated with a company with relatively more market liquidity risk would need to be higher than a company with relatively less market liquidity risk.

Q. Does Unitil's smaller size impact other aspects of equity capital?

A. Yes. As a result of Unitil's smaller relative size, the flotation costs typically incurred during an equity offering are defrayed by smaller relative issuances. Flotation costs include underwriting, legal, and other expenses realized as a result of issuing equity capital. Attachment JC-9 in Mr. Cochrane's testimony illustrates the flotation costs incurred by both Unitil Corp. and the peer group. Given that Unitil Corp. is smaller than its peers, its equity offerings are predictably smaller than its peers. While certain issuance expenses such as underwriting expense is often negotiated as a percentage of the share price, other issuance expenses, such as legal and audit expense, are somewhat fixed. Consequently, Unitil's flotation costs, expressed as a percentage of proceeds, have been more than 200 basis points higher than the peer group average. On balance, the higher flotation cost warrants a somewhat higher cost of equity.

Q. What consideration should be given in this docket pertaining to Northern's credit metrics, small company size and low liquidity?

A. The pressure on credit metrics as well as the Company's small relative size and relatively low liquidity should all be considered by the Commission with regard to the proposed Cost of Equity and capital structure. Investment-grade credit metrics are essential in order to access capital markets at competitive terms, as are strong financial and regulatory results to limit the inherent pressures that smaller investor-owned utilities are faced with. In Mr. Cochrane's direct testimony he approximates that the small size risk premium, as it relates to the Company's cost of equity, is about 150 basis points relative to the peer group average.

VII. CONCLUSION

Q. Do you believe the proposed capital structure and proposed return on rate base are reasonable?

A. Yes.

Q. Does this conclude your testimony?

A. Yes.

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