STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

Re: Pittsfield Aqueduct Company, Inc.

Debt Financing

DW 18-

DIRECT PREFILED TESTIMONY OF LARRY D. GOODHUE

March 8, 2018

Q.

Q. What is your name and what is your position with Pittsfield Aqueduct Company, Inc.?

A. My name is Larry D. Goodhue. I am the Chief Executive Officer of Pittsfield Aqueduct Company, Inc. (the "Company" or "PAC"). I have been employed with the Company since December, 2006. I also serve as Chief Executive Officer, Chief Financial Officer, and Treasurer of the Company's parent, Pennichuck Corporation ("Pennichuck"). I am a licensed Certified Public Accountant in New Hampshire; my license is currently in an inactive status.

Q. Please describe your educational background.

A. I have a Bachelor in Science degree in Business Administration with a major in Accounting from Merrimack College in North Andover, Massachusetts.

Q. Please describe your professional background.

A. Prior to joining the Company, I was the Vice President of Finance and Administration and previously the Controller with METRObility Optical Systems, Inc. from September, 2000 to June 2006. In my more recent role with METRObility, I was responsible for all financial, accounting, treasury and administration functions for a manufacturer of optical networking hardware and software. Prior to joining METRObility, I held various senior management and accounting positions in several companies.

Q. What are your responsibilities as Chief Executive Officer of the Company, and Chief Executive Officer, Chief Financial Officer and Treasurer of Pennichuck?

A. Including my primary responsibilities as Chief Executive Officer, with ultimate responsibility for all aspects of the Company, I am responsible for the overall financial management of the Company including financing, accounting, compliance and budgeting. My responsibilities include issuance and repayment of debt, as well as quarterly and annual financial and regulatory reporting and compliance. I work with the Chief Operating Officer of the Company to determine the lowest cost alternatives available to fund the capital requirements of the Company, which result from the Company's annual capital expenditures and its current debt maturities.

Q. Please provide the Commission with an explanation of the purpose of the financing proposed by the Company in its petition in this proceeding (the "Proposed Financing").

A. The primary purpose of the Proposed Financing is two-fold: (1) to refinance a 10-year $776,850 7% fixed rate intercompany note payable between the Company and Pennichuck which matures on May 1, 2018, and (2) to convert $409,150 of variable rate short term intercompany debt to a long term note payable. The 10-year fixed rate note was originally established when Pennichuck was a publicly-traded company, and as such, had access to both the debt and equity markets as sources of capital funding. When this loan was initially established as an interest-only repayment term loan, it was anticipated that it would either be refinanced "in kind" at maturity, or most likely repaid in full with money that was funded by equity raised by Pennichuck, as an infusion of equity into the Company by converting the debt obligation to equity at that time. Under the current ownership structure of Pennichuck, this option is no longer available, which is the basis for the nature in which this obligation is proposed to be refinanced at this time; as a fully amortizing debt obligation going forward.

Q. Please describe the debt that PAC is seeking authority to incur.

A. PAC is seeking authority to refinance the currently maturing $776,850 intercompany loan between Pennichuck and the Company, in addition to converting $409,150 of existing short term intercompany debt, and aggregating the two amounts together into one new long term intercompany note payable.

Q. **What are the basic terms of the proposed new intercompany loan**?

A. The new intercompany loan would be in the aggregate amount of $1,186,000, repaid over a 30 year term, on a fully amortizing basis, at an interest rate of 3.2%. The proposed debt would accomplish the following: (1) by extending the current amount due under the maturing intercompany loan further into the future, it will allow for a better matching of the life of our long term debt to the underlying lives of the assets; (2) provide for favorable debt carrying costs of 3.2%; and (3) reduce the level of our short term debt that is currently above the statutory 10% limit of net fixed plant. The Commission has approved an 18% limit for the Company in Order 25,820 (DW 15-288) until June 30, 2019, contingent upon the fact that the Company must provide written notice to the PUC Staff and OCA if the Company's performance under this measure shall exceed 15%. As of December 31, 2017, the Company's short term debt is calculated to be 12.98% of net fixed plant.

Q. Are there any other important terms or benefits related to this financing and refinancing activity?

A. Yes, other than the fact that the $776,850 intercompany loan is maturing on May 1, 2018, and needs to be refinanced as of that date, this financing approval will accomplish a better match of long term debt to long term capital investments for the Company. As of December 31, 2017, the Company has approximately $2.57 million of net plant in service, net of CIAC. As of this date, the Company also has approximately $948,000 of long term debt which is comprised of one outstanding obligation under the State Revolving Fund ("SRF") loan program (with a balance due of approximately $171,000) and the $776,850 Intercompany Loan. As such, these amounts represent the fact that approximately $1.6 million of net plant has been funded by short term working capital advances from Pennichuck in the 10 years since the current intercompany loan was put in place. Achieving this overall financing at this time, including the conversion of essentially the entire $410,667 balance of net short term amounts due to Pennichuck from the Company as of December 31, 2017, will more effectively match the Company's long term debt obligations to the underlying long term capital investments it currently has on its books and records.

Q. What are the estimated issuance costs for these loans?

A. The anticipated issuance costs total less than $2,000, and relate primarily to legal costs which will be incurred to (i) review and revise the necessary loan documentation for the intercompany loans and (ii) obtain Commission approval of the loans. The issuance costs will be amortized over the life of the new loan. The annual amortization expense of less than $67 associated with the issuance costs has not been considered in Schedules LDG-2 through 3 due to its immateriality with respect to the overall analysis and impact of this proposed financing.

Q. What other options did the Company considered for the proposed financing and refinancing?

A. The Company has explored options with several potential funding agencies over the past several years. The Company determined that SRF lending is not available as the monies would be used to refinance existing intercompany indebtedness rather than to finance new and eligible capital expenditures as required by the SRF lending program. As a result, the options to refinance the existing long term and short term debt was limited to taxable debt from banks or other financial institutions. As to debt funding from commercial banks or bonding, the Company determined a similar lack of availability either due to: its small size with respect to revenues and assets; the financial structure of the company with respect to normal debt-equity ratios; or its inability to meet normal financial covenants or achieve acceptable credit ratings. This was specifically tested by the Company in the past, when CoBank was asked to consider funding capital projects for the Company, like it does for the Company's sister subsidiary, Pennichuck East Utility, Inc. (PEU). We were told that the Company did not have sufficient financial resources to be considered as a lendable entity for CoBank, due to its small size. Additionally, the Company does not have the critical mass of capital borrowing needs to even consider accessing the tax-exempt or taxable bond markets, as the point of entry for those markets approximates offerings of $10 million or more for individual or 3-5 year issuance periods, neither of which is remotely comparative to the Company's capital project needs. At the end of the process, Intercompany loans became the only viable option to refinance the existing debt amounts.

Q. Please explain Schedule LDG-1 Balance Sheet for the twelve months ended December 31, 2017.

A. Schedule LDG-1 presents the actual financial position of PAC as of December 31, 2017 and the pro forma financial position reflecting certain adjustments pertaining to the Proposed Financing.

Q. Please explain the pro forma adjustments on Schedule LDG-1.

A. Schedule LDG-1 reflects the pro forma adjustment in the intercompany debt line for the conversion of $409,150 of short term intercompany debt to a $409,150 long term intercompany note payable, aggregated with the refinance of the existing $776,850 long term intercompany note payable (which is included in the Intercompany advances amount of $1,200,472 at December 31, 2017, as it is within 12 months of maturity as of that date, in conformity with GAAP reporting purposes). Additionally, the impact of the reduction in intercompany interest expense from this refinance, net of its tax impact at the new federal income tax rate (and the effective state income tax rate for 2017) is reflected on this schedule, as it would flow thru from the proforma adjustments included on LDG-2, as described immediately below.

Q. Mr. Goodhue, please explain Schedule LDG-2 Income Statement for the twelve months ended December 31, 2017.

A. As I indicated above, the costs associated with the refinancing are not expected to be significant and are not reflected in Schedule LDG-2. Schedule LDG-2 presents the pro forma impact of this financing on PAC's income statement for the twelve month period ended December 31, 2017.

Q. Please explain the pro forma adjustments on Schedule LDG-2 and its supporting schedule.

A. Schedule LDG-2 contains two adjustments. Adjustment one is to record the estimated change in intercompany interest expense related to the refinancing activity. As indicted earlier in this testimony, the new loan will carry an interest rate of 3.2%. The second adjustment is to record the after-tax effect of the additional pro forma interest expense using an effective combined federal and state income tax rate of 27.48%, based upon the new Federal tax rate of 21% and the 2017 NHPBT rate of 8.2%.

Q. **Please explain how the interest rate of 3.2% was derived for the long term intercompany note payable of $1.186 million in Schedule LDG-2.**

A. The Company determined that a rate of 3.2% would be appropriate, as it approximates Pennichuck's current cost of funds on its Line of Credit, which is Pennichuck's only source of debt financing, and as a result, the eventual source of funds to be lent to the Company through intercompany obligations. This interest rate is also on par with current intercompany debt refinancing activities pending final approval for PEU, in its long term intercompany borrowings with Pennichuck. The existing and maturing intercompany note was executed when Pennichuck was a publicly-traded company, and as such, the higher interest rate was reflective of the cost of funds from equity raises and a return on equity, as that was the source of the funds lent to the Company at that time.. The 3.2% interest rate on the proposed intercompany note reflects the elimination of the need to fund equity investment under the current ownership structure, with the commensurate rate of return that would be coupled with those equity investments.

Q. **Please explain Schedule LDG-3 Statement of Capitalization for the twelve months ended December 31, 2017.**

A. Schedule LDG-3 illustrates PAC's pro forma total capitalization as of December 31, 2017, which is comprised of common equity and long term debt including intercompany notes payable.

Q. **Please explain the pro forma adjustments on Schedule LDG-3.**

Schedule LDG-3 contains one adjustment. In the column of pro forma adjustments it reflects the elimination of the Municipal Acquisition Regulatory Asset, ("MARA") and the related equity as of the date of the Nashua acquisition per Order 25,292 in DW 11-026.

Q. Has PAC's Board of Directors formally voted to authorize the Proposed Financing?

A. Yes. Attachment A reflects the Resolutions authorizing the subject financing at the Company's board meeting held on February 23, 2018. However, this Resolution is being modified and has been submitted for re-approval at the upcoming March 23, 2018 board meeting for the Company, as the overall dollar approval has been reduced to $1,186,000, in order to reflect the final balance of the short term payable position of the Company (to Pennichuck) as of December 31, 2017, giving consideration to final adjustments made at year-end. Originally, the Company was seeking to convert $599,150 of short term intercompany borrowings to long term debt, based upon the preliminary short term payable position at that juncture. However, the short term payable position of the Company as of December 31, 2017 was reduced to $410,667 after the completion of the year-end closing process, and the booking of all final tax accounting entries. The goal in this portion of the refinancing is to convert essentially all of the short term payable at December 31, 2017, aggregating it with the maturing note payable, to a new note amount in even "thousands of dollars," as a part of this petition for approval. The Company is not petitioning to convert the entire amount that the net plant in service exceeds the Company's long term debt position, as it is seeking to convert a short term intercompany payable balance to a short term intercompany receivable between the Company and Pennichuck, as of the pro forma balances at December 31, 2017.

Q. **Do you believe that the Proposed Financing is in the public interest?**

A. Yes. The terms of the financing through are extremely favorable, and represent the only real financing option available to PAC to refinance existing short term and long term intercompany debt. Additionally, the term of the new loan, on a fully amortizing basis, better aligns the overall cost of funds with the underlying of the financed long term net plant assets.

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

A. Yes it does.