Q. Further to the response to PUB-NP-034, would any of the credit metrics at the different returns on equity and capital structures stated in the response be problematic with respect to Newfoundland Power maintaining its credit rating or issuing First Mortgage bonds?

A. **A. Maintaining the Credit Rating**

The cash flow to debt coverage credit metric is the only specific metric referred to in the response to Request for Information PUB-NP-034 that either Moody's Investors Service ("Moody's") or DBRS Limited ("DBRS") refer to in their rating outlooks.[1]

Table 1 shows the *pro forma* cash flow to debt coverage credit metric, as provided in the response to Request for Information PUB-NP-034.

Table 1
Cash Flow to Debt Coverage

	9.50%	**9.25%**	**9.00%**	**8.75%**	**8.50%**
45	17.8%	17.6%	17.4%	17.2%	17.0%
44	17.6%	17.4%	17.2%	17.0%	16.8%
43	17.5%	17.3%	17.1%	16.9%	16.7%
42	17.3%	17.1%	16.9%	16.7%	16.5%
41	17.1%	16.9%	16.7%	16.6%	16.4%
40	16.9%	16.7%	16.6%	16.4%	16.2%

In considering the ratings outlook for Newfoundland Power, Moody's states:

> *"The stable rating outlook reflects the PUB's regulation of NPI which we consider credit supportive. We expect the regulatory environment to remain supportive to credit quality, with a suite of timely recovery mechanisms, along with the expectation that relatively stable cash flow generation and the capital structure of NPI will generate sustained CFO pre-WC to debt in the 17-20% range."*[2]

For the scenarios shaded in grey, the *pro forma* metric is either at or below 17.0%. Seventeen percent is the bottom of the range of cash flow to debt coverage that Moody's expects Newfoundland Power to generate. Newfoundland Power would consider an inability to generate cash flow to debt coverage of 17.0% or more to be problematic from

[1] See *Volume 1, Application, Company Evidence and Exhibits*, *Exhibit 4*, *Moody's Credit Rating Report, page 2*.
[2] Ibid.

the perspective of maintenance of its current credit rating.[3]

B. Issuing First Mortgage Bonds

The earnings test interest coverage metric is used by the Company when issuing First Mortgage Bonds. While similar to the pre-tax interest coverage ratio, it is calculated as defined in the Company's Deed of Trust and Mortgage (the "Trust Deed").[4] The Trust Deed requires an earnings test interest coverage of 2.0 times or higher for the Company to issue additional bonds.

Table 2 shows the *pro forma* earnings test interest coverage metric, as provided in the response to Request for Information PUB-NP-034.[5]

Table 2
Earnings Test Interest Coverage (times)

	9.50%	**9.25%**	**9.00%**	**8.75%**	**8.50%**
45	2.48	2.43	2.38	2.34	2.29
44	2.37	2.32	2.28	2.23	2.19
43	2.26	2.22	2.18	2.14	2.10
42	2.24	2.20	2.16	2.12	2.08
41	2.21	2.17	2.13	2.09	2.06
40	2.18	2.14	2.11	2.07	2.03

For the scenarios shaded in grey, the *pro forma* earnings test interest coverage is below 2.15 times. In the Company's view, a *pro forma* earnings test interest coverage *below* 2.15 times may not provide adequate financial flexibility to ensure the continued ability to issue First Mortgage Bonds. Newfoundland Power would consider earning test interest coverage of below 2.15 times to be problematic from the perspective of the Company's ability to issue First Mortgage Bonds in all market conditions.

[3] Credit metrics, including the Company's cash flow to debt coverage, are among several factors considered by credit rating agencies in determining Newfoundland Power's credit rating. Other factors considered include the Company's regulatory framework and ability to recover its costs and earn a return. For more information, see PUB-NP-083.

[4] *Deed of Trust & Mortgage By Newfoundland Light & Power Co. Limited*, dated September 15, 1966, Article 6.2. The Trust Deed requires that *"No additional bonds shall be certified and delivered hereunder unless the Net Earnings of the Company for the Earnings Period selected by the Directors shall have been at least two (2) times the maximum annual interest charges on all Bonds to be outstanding after the proposed issue of Additional Bonds."*

[5] The *pro forma* calculations are based on forecast earnings and forecast debt issuance costs. Actual earnings test interest coverage is significantly dependant on actual financial results. Actual financial results can be impacted by many factors, including the economy, severe weather and capital markets. Newfoundland Power needs to maintain access to capital markets in all conditions if it is to have the ability to issue First Mortgage Bonds to finance its capital investments. As a result, a certain degree of financial flexibility is reasonably required to respond to unforeseen events that may impact the financial results of the Company.