

NORTHERN UTILITIES, INC.

TESTIMONY OF
DAVID L. CHONG
IN SUPPORT OF ISSUANCE OF UP TO \$75,000,000 IN LONG-TERM DEBT

New Hampshire Public Utilities Commission
Docket No. DG 17-____

1 **Q. Please state your full name and business address.**

2 A. My name is David L. Chong. My business address is 6 Liberty Lane West, Hampton,
3 New Hampshire, 03842.

4 **Q. By whom are you employed and in what capacity?**

5 A. I am Director of Finance and Treasurer for Unitil Service Corp., a subsidiary of Unitil
6 Corporation that provides managerial, financial, regulatory and engineering services to
7 Unitil Corporation's utility subsidiaries. I am also the Treasurer of Northern Utilities,
8 Inc. (hereinafter referred to as "Northern Utilities" or the "Company") and Unitil
9 Corporation's other utility subsidiaries. My responsibilities are primarily in the areas of
10 financial planning and analyses, regulatory projects, treasury operations and banking
11 relationships.

12 **Q. Please summarize your professional and educational background.**

13 A. I have over fifteen years of professional experience in the energy and utilities industries.
14 From 2001 through 2005, I worked for Exxon Mobil Corporation in various facilities
15 engineering roles with my last position as a Senior Project Engineer. From 2005 through
16 2008, I worked for RBC Capital Markets Corporation in the energy investment banking
17 group, where I provided corporate finance and mergers and acquisitions advisory
18 services. While at RBC, I raised equity and debt capital on numerous occasions for
19 various energy companies. I also advised on several buy-side and sell-side mergers and
20 acquisitions transactions. From 2008 through 2009, I worked for El Paso Exploration &
21 Production Company in its business development group as an Acquisition & Divestiture
22 Principal. I began working for Unitil Service Corp. in August 2009 as Director of

1 Finance. I hold a Master's Degree in Business Administration from Tulane University
2 and a Bachelor of Science degree in Mechanical Engineering with Honors from the
3 University of Texas at Austin.

4 **Q. Have you previously testified before the Commission or other regulatory agencies?**

5 A. Yes, I have testified before the New Hampshire Public Utilities Commission (the
6 "Commission") on various financial, ratemaking and utility regulation matters, including
7 utility cost of service and revenue requirements analysis. I have also testified before the
8 Maine Public Utilities Commission and Massachusetts Department of Public Utilities on
9 similar matters on several occasions.

10 **Q. What is the purpose of your testimony?**

11 A. The purpose of my testimony is to explain and support the Company's F-4 petition
12 requesting authorization to issue to institutional investor(s) senior notes evidencing
13 unsecured long-term debt in an aggregate amount of up to \$75,000,000 (hereinafter
14 referred to as the "Notes"). The Company is filing at the same time an identical petition
15 for authorization to issues securities with the Maine Public Utilities Commission.

16 **Q. What is the Company specifically requesting at this time?**

17 A. Northern Utilities is seeking the Commission's approval to issue an aggregate principal
18 amount of up to \$75,000,000 of Notes. The Notes will be sold at par and will have mixed
19 maturities and bear a fixed coupon of not more than 5.50%.

20 **Q. What tranches of long-term debt does the Company currently have outstanding?**

21 A. Northern Utilities completed its last long-term debt financing in October 2014 when it
22 issued \$50,000,000 of 4.42% senior notes due October 2044. This financing was

1 approved by the Commission by Order 25,670 issued May 23, 2014 in Docket DG 14-
2 101. The Company also has a \$25,000,000 tranche of 5.29% senior notes due March
3 2020 outstanding. See, Order No. 25,068 in Docket DG 09-239, issued on January 22,
4 2010. Finally, the Company has two other tranches of debt outstanding including
5 \$20,000,000 of 6.95% senior notes due December 2018 and \$50,000,000 of 7.72% senior
6 notes due December 2038. See, Order No. 24,905, Docket DG 08-079, issued October
7 10, 2008.

8 **Q. What capital improvements have been made to the Company's distribution system**
9 **since the last financing in October 2014?**

10 A. The Company has spent \$112 million on distribution system capital expenditures from
11 October 2014 through December 31, 2016 in New Hampshire and Maine combined. In
12 addition, the Company has \$42 million of capital expenditures budgeted for calendar year
13 2017. A summary of this spending by major category is included in Schedule DLC-1.

14 **Q. How does the Company finance its capital expenditures?**

15 A. The funding to meet capital expenditures is derived primarily from internally generated
16 funds, which consist of net cash flows including depreciation from operating activities.
17 Northern Utilities supplements internally generated funds through short-term borrowings
18 under the Unitil Corporation Cash Pool, which is supported by bank borrowings under
19 Unitil Corporation's credit facility. When the Company's short-term balance builds to
20 sufficient levels, it will seek a long-term financing to reduce the short-term debt and to
21 appropriately match the long-term utility asset lives with long-term funding.

22 **Q. Why is the Company looking to access the debt capital markets at this time?**

1 A. Northern Utilities' short-term borrowings were \$37.0 million as of December 31, 2016.
2 Additionally, according to the Company's cash forecasts, excluding the proceeds of this
3 financing, the Company expects its short-term borrowings to increase in 2017 to
4 approximately \$65 million by December 31, 2017. The Company's capital expenditure
5 program and sinking fund redemptions of \$10.0 million in 2017 are driving the
6 Company's short-term borrowings in the near term. The Company believes it is an
7 optimal time to pursue a long-term debt financing to address its projected capital needs.

8 **Q. You indicated that the Company has sinking fund retirements. Please provide a**
9 **schedule of the Company's long-term debt maturity profile.**

10 A. Please see Schedule DLC-2.

11 **Q. What is the use of proceeds of this offering?**

12 A. Northern Utilities is targeting to fund this offering in October 2017. The Company
13 expects to refinance all its short-term debt at the time of funding, and any excess cash
14 will be used for general corporate purposes, including refinancing \$10.0 million of
15 sinking fund retirements in December 2017.

16 **Q. Please describe the key terms of the proposed long-term debt financing.**

17 A. Northern Utilities is targeting to issue, at par, to institutional investors unsecured senior
18 notes in an aggregate amount of up to \$75 million. The Notes are expected to be issued
19 under similar terms and provisions of the Note Purchase Agreements of the existing
20 senior note tranches. The Company is targeting a mix of long-term maturities between
21 10-year and 30-year issuances. A mix of tenors allows for the Company to match the
22 long-lived nature of its utility assets with the long-term average life of the securities

1 while achieving an attractive and market-based overall weighted yield. Furthermore, an
2 issuance of mixed maturities ensures that the Company is not exposed to refinancing risk
3 at a single point in time, and instead provides for the ability to access the market at
4 multiple times to diversify its financing risk. The Company will work closely with its
5 Placement Agents, to determine the ultimate size of the offering, maturities, coupon and
6 other terms based on market conditions and investor interest at the time of pricing.

7 **Q. What is the Company's credit rating?**

8 A. Unitil and its utility subsidiaries, including Northern Utilities, have issuer ratings of
9 BBB+ by Standard & Poor's rating agency. Additionally, the Company's current
10 outstanding senior notes have a private rating of NAIC-2 by the National Association of
11 Insurance Commissioners (NAIC) which is the regulatory agency of the Company's
12 existing insurance investors. An NAIC-2 rating is generally considered in the financial
13 community to be equivalent to the BBB investment grade range of ratings by Standard
14 and Poor's rating agency. Unitil's Placement Agents plan to market this offering as a
15 BBB+ investment grade credit.

16 **Q. How was the maximum coupon rate the Company is proposing in this petition**
17 **derived?**

18 A. As part of its initial due diligence for this offering, the Company has met with its
19 Placement Agents to obtain market and preliminary pricing information. Based on this
20 review the Company is requesting a maximum coupon rate of not more than 5.50%. The
21 Placement Agents indicate that credit spreads for comparable BBB+ recently completed
22 utility deals have been in the 110-135 bps area for a 10-year issuance and the 135-160

1 bps area for a 30-year issuance over the comparable U.S. Treasury yields. This would
2 imply indicative all-in coupon rates as of January 20, 2017 for a 10-year maturity of 3.58-
3 3.83% (10-year US Treasury of 2.48%) and for a 30-year maturity of 4.40-4.65% (30-
4 year US Treasury of 3.05%). Coupon rates for terms longer than 10 years but shorter
5 than 30 years would generally be priced off an interpolation of the US Treasury rates.
6 Market conditions can rapidly change, and the Company does not anticipate pricing until
7 March 2017. Therefore, the Company is requesting a coupon rate that provides for
8 flexibility in the credit spread and maturities, and in the event treasury yields widen from
9 the date of the filing of this petition and to pricing. The Company asks that the
10 Commission proceed expeditiously with its review of the proposed financing to reduce
11 the risk of interest rate volatility. As explained later, the Company will submit an update
12 to the Commission of the final coupon rate once the Notes have been priced.

13 **Q. How will the Notes offering affect the capital structure of the Company?**

14 A. The Company's actual and pro forma capital structure is shown below. On a total
15 leverage basis, including short-term debt, the Company's net debt-to-net capitalization
16 ratio will remain at 53.8% on an actual and pro forma basis, since the net proceeds of the
17 offering will be used to repay short-term debt. With the reduction in short-term debt, the
18 Company will have the benefit of having a stronger balance sheet to finance its ongoing
19 capital construction program.

NORTHERN UTILITIES, INC.
CAPITAL STRUCTURE AS OF DECEMBER 31, 2016
Proformed for the Issuance and Sale of \$75,000,000 Senior Unsecured Notes
(\$ in Millions)

	<u>Actual</u> <u>12/31/2016</u>	<u>Adjustments</u> <u>12/31/2016</u>	<u>Pro Forma</u> <u>12/31/2016</u>
Cash	\$ 0.5	\$ 37.5	\$ 38.0
Short-Term Debt	\$ 37.0	\$ (37.0)	\$ -
Senior Unsecured Notes, Net of Issuance Costs	144.1	74.5	218.6
Total Debt	\$ 181.1	\$ 37.5	\$ 218.6
Common Equity	155.2	-	155.2
Net Capitalization	\$ 335.8	\$ -	\$ 335.8
Net Debt / Net Capitalization	53.8%		53.8%

1 **Q. How will the Notes offering affect the Company's weighted cost of long-term debt?**

2 A. The Company's weighted cost of long-term debt is currently 6.16% which reflects the
 3 weighted cost of the Company's existing tranches of debt discussed previously. This
 4 offering, at a maximum coupon rate of 5.50%, will lower the Company's weighted cost
 5 of long-term debt to a rate of 5.96%.

6 **Q. What are the projected issuance costs for the proposed Notes offering?**

7 A. The Company selected joint Placement Agents for this transaction. Under the terms of
 8 the engagement letter with the Placement Agents, Northern Utilities will pay a placement
 9 fee of 0.45% of the principal amount of the Notes at the time of closing. Additionally,
 10 the Company will be responsible for legal expenses, including all fees and expenses of

1 both the Company's and investor's counsel incurred in commencing the offering and sale
2 of the Notes. The Company has estimated total legal costs of \$200,000 for this
3 transaction, including legal services for corporate financing and regulatory services as
4 well as the cost for investor's counsel. In total, the Company estimates that the costs
5 associated with the issuance of the Notes will be about \$537,500 if the full \$75 million is
6 issued.

7 **Q. What types of investors participate in the private placement process?**

8 A. Typically, the investors for this type of transaction will be insurance companies that have
9 a demand for longer term maturity securities and have a strong familiarity with the utility
10 sector. The Placement Agents have recommended a strategy to market the Notes to a
11 select handful of existing and prospective private placement investors that are active
12 participants in the utility sector, are familiar with the Company's business and operations,
13 and that have demand for long-term securities. The Placement Agents have a strong
14 market presence within the utility sector and have recommended this marketing strategy
15 as the most appropriate for three reasons. First, this strategy recognizes the importance of
16 the Company's existing relationship with current investors and gives them an opportunity
17 to participate in a new issuance. Second, the Placement Agents are actively marketing
18 deals within the utility sector and therefore know which external investors are the most
19 likely to show strong interest and make competitive offers. Third, the Placement Agents
20 have indicated that given the size of the issuance of up to \$75 million, a competitive
21 market can best be established with the above strategy. The Placement Agents expect

1 this strategy will yield competitive offer(s) indicative of current utility BBB+ market
2 conditions.

3 **Q. Does Northern Utilities expect the private placement market to be receptive to this**
4 **offering?**

5 A. Yes. Northern Utilities believes that the private placement market will be receptive to
6 this offering, similar to the previous deal completed by the Company in October 2014,
7 where the Company was viewed favorably by the private placement market. According
8 to the Placement Agent, investors have been attracted by the Company's growth and
9 performance in its sector and strong management team, and will welcome the opportunity
10 to invest further in Northern Utilities. In addition, the regulated nature of distribution
11 utilities generally are targeted investment alternatives for some investors.

12 **Q. What is the timetable for the proposed Notes offering?**

13 A. The Company expects to market and price the Notes offering in March 2017 subject to
14 regulatory approval. Once the offering is priced, the Company will submit an update to
15 the Commission with the final pricing parameters including coupon rate. The Company
16 is seeking funding in October 2017 (approximately six months after pricing). Thus, there
17 will be a two-part closing process, with a paper execution closing three-months (June 30,
18 2017) after pricing, and final closing and funding six-months (October 2, 2017) after
19 pricing. While this timetable is currently the Company's best estimate, it is possible that
20 due to unforeseen market or other conditions, the timing may be adjusted.

21 Based on this timeline, Northern Utilities is requesting an Order from the Commission
22 approving the Notes offering on or before May 30, 2017. This will provide for the

1 necessary expiration of the appeal period prior to the first closing expected to occur June
2 30, 2017.

3 **Q. Has the Company's Board of Directors approved the proposed financing?**

4 A. Yes, on January 25, 2017 the Company's Board of Directors approved an issuance of up
5 to \$75,000,000 of Notes. A copy of the Board's resolution is provided in Exhibit NU-11.

6 **Q. Does this conclude your testimony?**

7 A. Yes, it does.

INDEX OF SCHEDULES:

Schedule DLC-1	Historical and Budget Capital Spending
Schedule DLC-2	Long-Term Debt Maturities