

1 Q. Describe in detail the financial and/or operational or other business risks to
2 which Hydro is subject which a fully informed investor would consider in
3 determining the risk premium to be demanded for an investment in Hydro.

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6 A. An informed investor would look at the following aspects of Hydro's business
7 and financial risk:

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9 Market Profile

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- 11 • Industrial diversity of economy
- 12 • Outlook for growth in service area
- 13 • Degree to which revenues are concentrated among a small number of
- 14 customers
- 15 • Competition with alternative energy sources
- 16 • Bypass opportunities/cost structure

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18 Operational/Supply Profile

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- 20 • Climate/geography
- 21 • Extent to which system is interconnected/isolated
- 22 • Sources of generation (nuclear vs. thermal vs. hydro)
- 23 • Operational risks related to generation (e.g., water levels)
- 24 • Diversity of fuel supply sources
- 25 • Reserve capacity
- 26 • Transmission constraints

1 Regulatory Environment

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- 3 • Type of test year (historic vs. future)
- 4 • Regulatory protection (e.g., deferral accounts) from forecasting risks,
- 5 e.g., load variations (weather/economy related), fuel costs/generation
- 6 mix, interest rates.
- 7 • Regulatory precedent regarding recovery of invested capital (used and
- 8 useful vs. prudently incurred; stranded costs)
- 9 • Level of returns allowed
- 10 • State of industry restructuring

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12 Financial Risks

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- 14 • Capital structure ratios
- 15 • Use of short-term debt
- 16 • Existence of debt guarantee
- 17 • Level of capital expenditures/need to access capital markets
- 18 • Interest coverage
- 19 • Level of free cash flows