

1 **Reference: Section 3: Finance**

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3 **Q. Provide a table that shows the *pro forma* earnings test interest coverage calculation**  
4 **which is required for Newfoundland Power to issue First Mortgage Bonds in 2023**  
5 **for the same range of equity ratios and allowed returns on equity as in PUB-NP-030**  
6 **(sic).**

7  
8 A. The earnings test interest coverage metric (the “Earnings Test”) is used by the Company  
9 when issuing First Mortgage Bonds. While similar to the pre-tax interest coverage ratio,  
10 it is calculated as defined in the Company’s Deed of Trust and Mortgage (the “Trust  
11 Deed”). The Trust Deed requires an Earnings Test of 2.0 times or higher for the  
12 Company to issue additional bonds.<sup>1</sup>

13  
14 Table 1 is a matrix which shows *pro forma* Earnings Test calculations as required for  
15 Newfoundland Power to issue First Mortgage Bonds in 2023, for the same range of  
16 equity ratios and allowed rate of returns on equity (“ROE”) as in Request for Information  
17 PUB-NP-029.<sup>2</sup>

**Table 1:**  
**Earnings Test Interest Coverage (times)**  
**2023 Pro Forma**

	<b>9.80%</b>	<b>9.50%</b>	<b>9.25%</b>	<b>9.00%</b>	<b>8.75%</b>	<b>8.50%</b>	<b>8.25%</b>
<b>45%</b>	2.64	2.58	2.53	2.47	2.42	2.37	2.32
<b>44%</b>	2.59	2.53	2.49	2.44	2.40	2.35	2.30
<b>43%</b>	2.54	2.48	2.44	2.40	2.35	2.31	2.26
<b>42%</b>	2.49	2.44	2.39	2.35	2.31	2.27	2.22
<b>41%</b>	2.44	2.39	2.35	2.31	2.27	2.22	2.18
<b>40%</b>	2.39	2.35	2.31	2.27	2.23	2.18	2.14
<b>39%</b>	2.35	2.30	2.27	2.23	2.19	2.15	2.10
<b>38%</b>	2.31	2.26	2.23	2.19	2.15	2.11	2.07
<b>37%</b>	2.27	2.22	2.19	2.15	2.11	2.07	2.03

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<sup>1</sup> *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.”

<sup>2</sup> The *pro forma* calculations are based on forecast earnings at the respective allowed ROEs and forecast interest rates based on the Company’s existing credit ratings. The calculations do not reflect increased finance charges that would be incurred if Newfoundland Power’s credit ratings were downgraded as a result of a Board order to reduce the Company’s equity component of capital structure. As a result, the *pro forma* calculations have practical limitations. For additional information, see response to Request for Information PUB-NP-033.

1 While the information in Table 1 provides *pro forma* Earnings Test calculations for 2023,  
2 the Earnings Test is dependant on the Company's actual financial results. Actual  
3 financial results can be impacted by many factors, including electricity sales, the  
4 economy, severe weather and capital markets. It is also dependant on interest rates  
5 determined by capital markets at the time debt is issued.  
6

7 The Earnings Test has ranged from 2.11 to 2.41 times for the Company's past 6 issues of  
8 First Mortgage Bonds,<sup>3</sup> with an average of 2.27 times.<sup>4</sup> For Newfoundland Power's most  
9 recent bond issues in 2020 and 2017, the Earnings Test was 2.32 and 2.41 times,  
10 respectively. These were above the recent average largely due to the continued low  
11 interest rate environment.<sup>5</sup>  
12

13 Newfoundland Power needs to maintain access to capital markets at reasonable costs in  
14 all economic and market conditions.<sup>6</sup> Due to the long-term nature of utility investments,  
15 the continued ability to access capital markets to issue First Mortgage Bonds requires a  
16 long-term view. Further, a certain degree of financial flexibility is reasonably required to  
17 respond to unforeseen events that may impact the financial results of the Company.

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<sup>3</sup> This includes: (i) Series AQ bonds at 2.32 times in 2020, (ii) Series AP bonds at 2.41 times in 2017, (iii) Series AO bonds at 2.26 times in 2015, (iv) Series AN bonds at 2.18 times in 2013, (v) Series AM bonds at 2.34 times in 2009, and (vi) Series AL bonds at 2.11 times in 2007.

<sup>4</sup>  $((2.32 + 2.41 + 2.26 + 2.18 + 2.34 + 2.11))/6 = 2.27$ .

<sup>5</sup> Series AQ First Mortgage Bonds were issued in April 2020 at an interest rate of 3.608%. Series AP First Mortgage Bonds were issued in June 2017 at an interest rate of 3.815%. These bonds reflect the lowest interest rates on bonds issued in the Company's history.

<sup>6</sup> For example, in March 2020 as a result of the COVID-19 pandemic, the Company was advised by its investment banker that bond investors were not receptive to a bond issue by Newfoundland Power at that time. The Company did subsequently issue \$100 million Series AQ First Mortgage Bonds in April 2020.