

BUTLER | SNOW

June 20, 2014

VIA HAND DELIVERY

Hon. James M. Allison, Chairman
c/o Sharla Dillon
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

RE: Petition of Tennessee-American Water Company for Approval of and Authority to Borrow Up to \$60,000,000 to Refinance Outstanding Indebtedness and Finance Additions and Improvements to Facilities and Acquisitions and to Repay Short-Term Indebtedness Pursuant to §65-5-109 TRA Docket No. 14-00061

Chairman Allison:

With this letter, I enclose Tennessee-American Water Company's Responses to the TRA's First Set of Data Requests in the above-referenced matter. Please find attached to this letter five (5) paper copies of the Company's response.

We appreciate your filing these responses. Please let me know if you have any questions.

With best regards, I am

Very truly yours,



Junaid A. Odubeko

JAO:sc
enclosures
cc: Cynthia Kinzer

ButlerSnow 21669354v1

*The Pinnacle at Symphony Place
150 3rd Avenue South, Suite 1600
Nashville, TN 37201*

JUNAID A. ODUBEKO
615.651.6732
junaid.odubeko@butlersnow.com

T 615.651.6700
F 615.651.6701
www.butlersnow.com

**TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 14-00061
FIRST DISCOVERY REQUEST OF THE
TENNESSEE REGULATORY AUTHORITY**

Responsible Witness: **Scott W. Rungren**

Question:

1. How much of the requested \$60 million in debt authority does Tennessee American Water Company ("TAWC") expect to use for acquisitions?

Response:

Tennessee American Water Company has not identified any specific acquisitions in the preparation of its financing application. As a result of its budgeting process, TAWC has estimated a need for approximately \$60 million of debt issuance approval through 2018, with only approximately \$5 million included for currently unplanned needs. Approximately \$20.571 million is related to potential refinancing of existing long-term debt.

In addition, proceeds from TAWC's various sources of external financing, including debt issuances, are indistinguishable, and are also indistinguishable from proceeds generated internally. This is due to cash being a fungible commodity. For a company with multiple funding sources, such as TAWC, it is not possible in a financial sense to project a specific use of funds to a particular source. Therefore, it is not possible to project precisely the manner in which the Company's acquisitions will be funded. The most reasonable assumption to use is that TAWC's acquisitions, if any, will be financed by the capital components that comprise its capital structure, and in the proportion that each component comprises that capital structure.

**TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 14-00061
FIRST DISCOVERY REQUEST OF THE
TENNESSEE REGULATORY AUTHORITY**

Responsible Witness: Scott W. Rungren

Question:

2. Provide the current capital structure for TAWC. Provide a pro forma capital structure for TAWC assuming the full \$60 million of requested indebtedness is issued.

Response:

The actual March 31, 2014 and projected December 31, 2018 capital structures are shown below. The projected capital structure does not reflect the full \$60,000,000 of requested debt approval, since \$20,571,022 is related to opportunities to refinance existing long-term debt. For example, the Company is planning to refinance its 6.00% Series Note in August 2014 (maturity date 12/1/2039), which currently has a face amount of \$10,571,022. The other issuance that may be refinanced is the Company's 6.00% Series Note (maturity date 10/15/2037), with a current face amount of \$10,000,000.

<u>Class of Capital</u>	<u>Actual at 3/31/2014</u>	<u>% of Total</u>
Short-Term Debt	\$ 13,207,099	9.59%
Long-Term Debt	60,724,498	44.10%
Common Equity	63,765,624	46.31%
Total Capitalization	\$ 137,697,220	100.00%

<u>Class of Capital</u>	<u>Projected Amounts at 12/31/18</u>	<u>% of Total</u>
Short-Term Debt	\$ 6,000,000	3.11%
Long-Term Debt	100,153,498	51.92%
Common Equity	86,761,982	44.97%
Total Capitalization	\$ 192,915,480	100.00%

**TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 14-00061
FIRST DISCOVERY REQUEST OF THE
TENNESSEE REGULATORY AUTHORITY**

Responsible Witness: **Scott W. Rungren**

Question:

3. Provide a calculation of TAWC's current interest coverage ratio. Provide an estimate of the interest coverage ratio assuming that all \$60 million of the requested debt authority is utilized. In the response, list all assumptions made in calculating the estimated interest coverage ratio.

Response:

The interest coverage ratios are as follows:

	Actual For 12-Months Ended <u>3/31/2014</u>	Projected 12-Months Ending <u>12/31/2018</u>
Interest Coverage Ratio	5.24	5.66

The ratio was calculated by dividing earnings before interest, taxes, depreciation and amortization (EBITDA) by net interest expense. Budgeted amounts were used for the 2018 projection, with the exception of two adjustments that were made to long-term interest.

One adjustment resulted from an update to the projected long-term debt balance. The updated amount is \$4,825,474 higher at December 31, 2018, and is consistent with that shown in the Company's response to TRA Data Request No. 1, question 2. For the purpose of calculating interest on this incremental debt, an interest rate of 4.52% was used, which is the projected July 1, 2018 rate for American Water Capital Corp. ("AWCC") as of June 17, 2014. See response to TRA Data Request No. 1, question 4.

The other adjustment was made to capture the annual interest reduction pertaining to the planned August 2014 refinancing of the Company's \$10,571,000 Note. The rate on that Note is 6.0%. For purposes of this analysis, it was assumed that it would be refinanced at 3.66%, which is the projected rate for a 10-year AWCC Note as of June 17, 2014. See the Company's response to TRA Data Request No. 1, question 4.

Also, it should be noted that the projected long-term debt balance, and thus, the calculation of long-term interest, does not reflect the full \$60,000,000 of requested debt approval, since \$20,571,022 relates to opportunities to refinance existing long-term debt.

**TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 14-00061
FIRST DISCOVERY REQUEST OF THE
TENNESSEE REGULATORY AUTHORITY**

Responsible Witness: Scott W. Rungren

Question:

4. Provide data showing current and projected interest rate spreads between corporate debt with similar credit ratings as those issued by American Water Capital Corp. and U.S. Treasury securities of similar term.

Response:

Data for each year is projected as of July 1.

	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Yield on 10-Year U.S. Treasury Bond	2.66%	2.99%	3.26%	3.42%	3.52%
Yield on 10-year A-Rated U.S. Utilities Spread	<u>3.26%</u> 0.60%	<u>3.72%</u> 0.73%	<u>4.13%</u> 0.87%	<u>4.48%</u> 1.06%	<u>4.79%</u> 1.27%
Yield on 10-year BBB-Rated U.S. Utilities Spread	<u>3.62%</u> 0.96%	<u>4.10%</u> 1.11%	<u>4.55%</u> 1.29%	<u>4.95%</u> 1.53%	<u>5.28%</u> 1.76%
AWCC's Assumed Credit Spread	<u>1.00%</u>	<u>1.00%</u>	<u>1.00%</u>	<u>1.00%</u>	<u>1.00%</u>
AWCC's Projected 10-Year Yield	3.66%	3.99%	4.26%	4.42%	4.52%

Source: Bloomberg Online, June 17, 2014

American Water Capital Corp. ("AWCC") is currently rated A- by Standard & Poor's. Since Bloomberg Online does not provide projections for utility bonds rated A-, the above table shows the spreads for both 10-year A rated Utilities and 10-Year BBB rated Utilities above that of the 10-year U.S. Treasury Bond. The last line of the table shows the Company's current expectation regarding the rate at which AWCC would issue bonds with a 10-year term. A one percent spread above the 10-year U.S. Treasury is assumed, consistent with the approximate spread reflected in the rate at which AWCC issued debt in November, 2013.