

**BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION**

**IN THE MATTER OF SOUTHWESTERN )  
PUBLIC SERVICE COMPANY'S )  
APPLICATION FOR: (1) REVISION OF )  
ITS RETAIL RATES UNDER ADVICE )  
NOTICE NO. 292; (2) AUTHORIZATION )  
AND APPROVAL TO ABANDON ITS )  
PLANT X UNIT 3 GENERATING )  
STATION; AND (3) OTHER )  
ASSOCIATED RELIEF, )  
SOUTHWESTERN PUBLIC SERVICE )  
COMPANY, )  
APPLICANT. )**

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**CASE NO. 20-00238-UT**

**DIRECT TESTIMONY**

*of*

**PATRICIA L. MARTIN**

*on behalf of*

**SOUTHWESTERN PUBLIC SERVICE COMPANY**

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## **GLOSSARY OF ACRONYMS AND DEFINED TERMS**

<b><u>Acronym/Defined Term</u></b>	<b><u>Meaning</u></b>
Base Period	October 1, 2019 through September 30, 2020
CCR	Corporate Credit Rating
CFO	Cash from Operations
Commission	New Mexico Public Regulation Commission
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortization
FFO	Funds from Operations
Fitch	Fitch Ratings
Moody's	Moody's Investors Service
RFP	Rate Filing Package
ROE	Return on Equity
SACP	Stand-alone Credit Profile
S&P	Standard & Poor's
SPS	Southwestern Public Service Company, a New Mexico corporation
Test Year	Historical Test Year Period consisting of the Base Period and further incorporating all proper adjustments and capital additions
WACC	Weighted Average Cost of Capital
Xcel Energy	Xcel Energy Inc.

## LIST OF ATTACHMENTS

<u>Attachment</u>	<u>Description</u>
PLM-1	Moody's October 19, 2018: Rating Action: Moody's Changes Xcel Energy's outlook to negative; downgrades Southwestern Public Service ratings to Baa2 with stable outlook <i>(Non-native format)</i>
PLM -2	Moody's January 17, 2020: Issuer Comment: Southwestern Public Service's rate-case stipulation agreement in New Mexico is credit positive <i>(Non-native format)</i>
PLM-3	S&P Global Ratings December 2, 2019: Ratings Direct: Southwestern Public Service Co. <i>(Non-native format)</i>
PLM-4	S&P Global Ratings November 6, 2018: Ratings Direct: Southwestern Public Service Co. <i>(Non-native format)</i>

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1           **I.       WITNESS IDENTIFICATION AND QUALIFICATIONS**

2   **Q.       Please state your name and business address.**

3   A.       My name is Patricia L. Martin. My business address is 414 Nicollet Mall,  
4            Minneapolis, Minnesota 55401.

5   **Q.       On whose behalf are you testifying in this proceeding?**

6   A.       I am filing testimony on behalf of Southwestern Public Service Company, a New  
7            Mexico corporation (“SPS”) and wholly-owned electric utility subsidiary of Xcel  
8            Energy Inc. (“Xcel Energy”).

9   **Q.       By whom are you employed and in what position?**

10  A.       I am employed by Xcel Energy Services Inc. as Assistant Treasurer.

11  **Q.       Please briefly outline your responsibilities as Assistant Treasurer.**

12  A.       As Assistant Treasurer, I am responsible for providing leadership, direction and  
13            technical expertise related to Treasury and finance processes and functions. I lead  
14            a professional team to provide financial analysis and recommendations on  
15            valuations of new investments, financial objectives and policies. I am also  
16            responsible for development and implementation of financial plans for regulated  
17            operating companies, execution of long-term debt and equity financings,  
18            establishing and maintaining banking relationships, and providing written  
19            testimony for capital structure and cost of capital.

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1 **Q. Please describe your educational and professional background.**

2 A. I have a Bachelor of Science degree in Business Administration from University  
3 of Wisconsin-Stevens Point and a Master of Business Administration from  
4 Edgewood College in Madison, Wisconsin. I have been employed by Xcel  
5 Energy since 2016, and have been in my current role as Assistant Treasurer since  
6 October 2019. From 2016 to September 2019, I was the Director of Treasury  
7 Forecasting at Xcel Energy with responsibilities for cash forecasting and long-  
8 term financial modeling. From 2012 to 2016, I was employed at Pacific Gas and  
9 Electric Company as Corporate Finance Manager in the Treasury Department  
10 (2012 – 2014) and as a Business Finance Manager supporting Gas Operations  
11 (2014 – 2016) From 2007 to 2012, I was employed by several start-up companies  
12 in Denver, Colorado including Mobile Accord (VP Finance and Chief  
13 Administrative Officer, 2010 – 2012), Local Matters (Director Financial Planning  
14 and Analysis, 2008 – 2010) and Pendum Inc. (Manager Financial Planning and  
15 Analysis/Treasurer, 2007 – 2008). From 2006 to 2007, I was employed by GE  
16 Healthcare as a Financial Planning and Analysis Manager. I was also employed  
17 by CUNA Mutual Group from 2004 to 2006 as the Manager of Forecasting,  
18 Planning and Analysis. And lastly, I was employed by Alliant Energy  
19 Corporation from 1998 to 2004 in several roles with progressively more

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1 responsibility including, Manager – Performance Consulting, Senior Financial  
2 Analyst and Senior Treasury Analyst.

3 **Q. Have you previously provided testimony before a regulatory commission?**

4 A. Yes. I submitted prefiled direct testimony before the New Mexico Public  
5 Regulation Commission (“Commission”) in Case No. 20-00052-UT<sup>1</sup> regarding  
6 SPS’s request to issue long-term debt. I also provided rebuttal testimony on  
7 financial integrity, cost of debt, and capital structure before the Public Utility  
8 Commission of Texas in Docket No. 49831,<sup>2</sup> SPS’s most recent Texas rate case.

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<sup>1</sup> *In the Matter of Southwestern Public Service Company’s Application for Authority to: Issue up to \$350 million on First Mortgage Bonds during 2020; (2) Recover Certain Refunding Costs; and (3) Enter into Agreements in Support of Interest Rate Hedging including Interest Rate Locks and Swaps, Case No. 20-00052-UT, Direct Testimony of Patricia L. Martin (Feb. 28, 2020).*

<sup>2</sup> *Application of Southwestern Public Service Company for Authority to Change Rates, Docket No. 49831, Rebuttal Testimony of Patricia L. Martin (Mar. 11, 2020).*





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- 1                   • Request the ability to exceed the current 55% equity cap for a period  
2                   of up to 90 days in order to allow SPS to more efficiently manage  
3                   cash;<sup>4</sup> and
- 4                   • Present and support SPS’s Base Period and Test Year cost of long-  
5                   term debt, which was 4.31%.

6   **Q.    Are you sponsoring any attachments as part of your direct testimony?**

7   A.    Yes, I am sponsoring the following attachments:

- 8                   • Attachment PLM-1, which is a Moody’s Investors Service’s  
9                   (“Moody”) publication titled *Moody’s changes Xcel Energy’s outlook*  
10                  *to negative, downgrades Southwestern Public Service ratings to Baa2*  
11                  *with stable outlook*
- 12                  • Attachment PLM-2, which is a Moody’s publication titled *Southwest*  
13                  *Public’s Service’s rate-case stipulation agreement in New Mexico is*  
14                  *credit positive*
- 15                  • Attachment PLM-3, which is a Standard & Poor’s (“S&P”) Global  
16                  Ratings publication titled *Southwestern Public Service Co.* from  
17                  December 2, 2019
- 18                  • Attachment PLM-4, which is an S&P Global Ratings publication titled  
19                  *Southwestern Public Service Co.* from November 6, 2018

20                  In addition, I sponsor or co-sponsor the Rate Filing Package (“RFP”)  
21                  schedules set forth in the following table:

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<sup>4</sup> See, e.g., *SPS Revision of Retail Electric Rates Pursuant to Advice Notice Nos. 217, 218 and 219 and Request for Expedited interim Relief*, Case No. 08-00354-UT, Uncontested Comprehensive Stipulation at 12.2 (May 28, 2009).

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**Table PLM-1**

<u>Schedule</u>	<u>Description</u>
A-5	Summary of total capitalization and the weighted average cost of capital
G-1	Capitalization, the cost of capital and the overall rate of return in conformance with an original cost Rate Base
G-3	Embedded cost of borrowed capital with term of maturity in excess of one year from date of issue
G-4	Cost of short-term borrowed capital
G-5	Embedded cost of preferred stock capital
G-6	Ratio of earnings to fixed charges
G-7	Issuance restrictions on borrowed and preferred stock capital
G-8	Common stock equity capital
G-9	Historical activity in common stock, paid-in capital, and retained earnings
J-2	Sources of construction funds

2 **Q. Please summarize the recommendations in your testimony.**

3 A. I recommend the Commission: (1) approve SPS's proposed Test Year WACC as  
4 shown in Table PLM-2 and (2) give SPS the ability to exceed the current 55%  
5 equity cap for a period of up to 90 days in order to allow SPS to more efficiently  
6 manage cash.

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**Table PLM-2**

		<b>Test Year WACC</b>	
	<b>Ratio</b>	<b>Rate</b>	<b>WACC</b>
Long-Term Debt	45.28%	4.31%	1.95%
Equity	54.72%	10.35%	5.66%
<b>Total Cost</b>			<b>7.61%</b>

2 **Q. Are Attachments PLM 1 through PLM-4 true and correct copies of the**  
3 **documents you represent them to be?**

4 A. Yes.

5 **Q. Were the portions of the RFP schedules that you sponsor or co-sponsor**  
6 **prepared by you or under your direct supervision and control?**

7 A. Yes.

8 **Q. Do you incorporate the RFP schedules sponsored or co-sponsored by you**  
9 **into your testimony?**

10 A. Yes.

1       **III. FINANCIAL INTEGRITY, RATING AGENCY METHODOLOGIES,**  
2       **AND SOUTHWESTERN PUBLIC SERVICE COMPANY**

3       **Q.     What topics do you discuss in this section of your testimony?**

4       A.     In this section of my testimony, I will:

- 5                     • Discuss financial integrity and the importance of this case in  
6                     supporting SPS’s future financial integrity;
- 7                     • Provide a current assessment of SPS’s financial integrity and the  
8                     related impact to SPS’s customers;
- 9                     • Identify both how SPS is working to maintain its financial integrity  
10                    and how its financial integrity could be strengthened through a  
11                    supportive regulatory decision in this case; and
- 12                    • Present and support the recommended 7.61% WACC as of the Test  
13                    Year ending December 31, 2020.

14       **A.     Financial Integrity**

15       **Q.     What is financial integrity?**

16       A.     As used in my testimony, “financial integrity” refers to a company’s financial  
17             strength and its ability to attract capital to support operations and infrastructure  
18             investment during periods of both economic growth and economic decline. The  
19             ability to attract capital at a reasonable cost in all market conditions is essential  
20             for a utility to be able to fulfill its obligation to provide safe and reliable utility  
21             service to customers. Achieving and maintaining strong financial integrity  
22             ensures that a utility will have the flexibility to withstand unanticipated  
23             macroeconomic events outside of its control, such as the COVID-19 pandemic.

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1 **Q. How does maintaining financial integrity benefit SPS's customers?**

2 A. SPS's financial integrity directly affects both the Company's ability to access  
3 capital to fund necessary investments on behalf of customers, and the cost of that  
4 capital ultimately included in overall rates. Attracting reasonably priced capital in  
5 all market conditions, including following unexpected macroeconomic events  
6 outside the Company's control, is also critical to being able to invest in the  
7 infrastructure necessary for SPS to provide safe and reliable utility service.

8 It is important to note that the question of a utility's financial integrity is  
9 not necessarily binary (i.e., does a utility have financial integrity or not?); rather,  
10 the degree of financial integrity and therefore the cost of capital available to a  
11 utility lies on a spectrum. Weaker financial integrity at a utility increases the  
12 issued cost of debt and the implied cost of equity, which increases the overall  
13 WACC and the ultimate financing costs that are paid by customers. Stronger  
14 financial integrity produces the opposite effects, which in turn benefits customers.

15 **Q. Have investor perceptions of SPS's regulatory environment impacted their  
16 view of SPS's financial integrity?**

17 A. Yes. As discussed in more detail in the Direct Testimony of Todd A. Shipman,  
18 regulatory outcomes are an important factor that rating agencies rely on to assess  
19 a utility's credit quality. In recent years, rating agencies have expressed concern

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1 about the rate proceeding outcomes in New Mexico and, to a lesser extent, Texas.  
2 The rating agencies have also emphasized the importance of moving toward  
3 balanced, constructive outcomes in utility rate proceedings. SPS views this case  
4 as an opportunity to shift investor opinion by demonstrating that another  
5 supportive regulatory outcome can be achieved in New Mexico, thereby  
6 indicating consistency and stability in rate making. This is a significant concern,  
7 especially in light of Moody's 2018 downgrade of SPS's standalone credit ratings  
8 to levels just two notches above junk bond status.

9 **Q. Have there been any recent outcomes in New Mexico that are positive and**  
10 **could serve as a starting point for improving investor perceptions of SPS's**  
11 **financial integrity?**

12 A. Yes. The settlement of SPS's most recent New Mexico rate case (Case No.  
13 19-00170-UT<sup>5</sup>) represents a positive step that could serve as a starting point for  
14 improving perceptions of New Mexico's regulatory impact on SPS's financial  
15 integrity. SPS believes the settlement was a positive step; however, in order to  
16 minimize the cost of SPS debt issuances, capital market investors need to see

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<sup>5</sup> *In the Matter of Southwestern Public Service Company's Application for: (1) Revision of its Retail Electric Rates Under Advice Notice No. 282; (2) Authorization and Approval to Shorten the Service Life and Abandon its Tolk Generating Station Units; and (3) Other Related Relief, Case No. 19-00170-UT, Uncontested Comprehensive Stipulation (Jan. 13, 2020).*

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1 consistency and a stable commitment to maintaining a supportive regulatory  
2 environment in New Mexico.

3 **Q. Does this case offer the opportunity to further improve investor perceptions**  
4 **regarding SPS's financial integrity?**

5 A. Yes. The Commission's approval of SPS's requested 7.61% WACC and  
6 regulated equity ratio of 54.72% in this case would be another positive step  
7 toward supporting SPS's current investment grade credit ratings and would help  
8 demonstrate ratemaking consistency and predictability. Mr. Shipman's testimony  
9 describes the factors that would put SPS on a path to improving its credit rating.  
10 Recovering a higher rating would ultimately benefit customers, as SPS would be  
11 better positioned to provide safe, clean and reliable electric service to its  
12 customers at a reasonable cost through all economic conditions.

13 **B. Factors Impacting Financial Integrity**

14 **Q. What factors contribute to a utility's financial integrity?**

15 A. The financial integrity of a regulated utility is largely a function of its capital  
16 structure, ROE, and cash flow, but other factors can also affect a utility's financial  
17 integrity. To maintain a strong financial profile, a utility needs to have the  
18 opportunity to recover all prudently-incurred utility costs in a timely manner,  
19 which includes not only the costs of capital investments and operations and

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1 maintenance expense, but also the costs of servicing debt and providing a fair  
2 return for equity investors.

3 **Q. How do regulatory outcomes impact rating agency perceptions and influence**  
4 **investor decisions?**

5 A. As discussed further in Mr. Shipman's direct testimony, credit rating agencies  
6 determine credit ratings, which investors may rely on for investment decisions.  
7 The rating agencies have emphasized that balanced, constructive outcomes in  
8 utility rate proceedings are indicative of a supportive stable regulatory  
9 environment and underpin a utility's financial integrity. This rate case presents an  
10 opportunity to achieve another positive outcome with respect to SPS's allowed  
11 equity ratio, which is similar to the currently-authorized equity ratio.

12 **Q. How do a utility's credit ratings affect its ability to access capital on**  
13 **reasonable terms?**

14 A. As Mr. Shipman discusses, a credit rating measures credit risk, which is the  
15 ability and willingness of an issuer to fulfill its financial obligations in full and on  
16 time. Credit ratings help debt investors differentiate between utilities – all of  
17 whom are competing (with companies within and outside the utility sector) for the  
18 same investment dollars. The credit ratings assigned by rating agencies indicate  
19 their opinions of a company's ability to meet its financial obligations. Rating

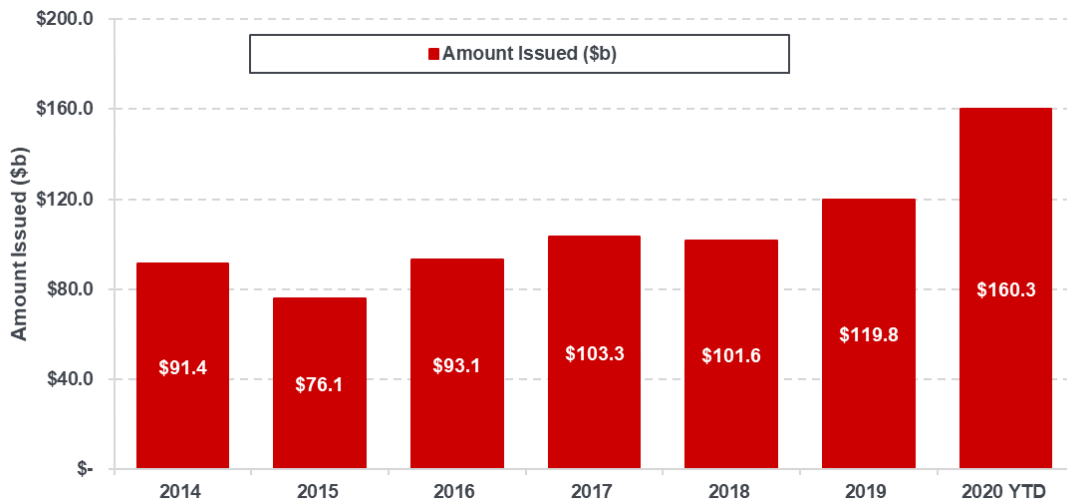


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1 agency opinions are considered valuable by potential investors because they  
2 represent independent, third-party opinions that are based upon a consistent  
3 approach to the evaluation of company risk over time. Ratings affect the number  
4 of potential investors and the cost of a company's debt, and offer important  
5 insight into a company's investment risk in the past and future.

6 During the period 2014 to November 2020, debt investors have provided  
7 approximately \$746 billion of capital investment to the U.S. utility sector. Capital  
8 provided from these investors allows utilities to fund a portion of their capital  
9 investment programs. See Chart PLM-1 below.

10 **Chart PLM-1: 2014 - November 2020 Debt Amount**  
11 **Issued to the U.S. Utility Sector<sup>6</sup>**



<sup>6</sup> Source: Bloomberg.

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1           In order to attract capital at favorable rates in a competitive environment,  
2           protecting SPS's credit ratings is critical. This becomes even more salient in a  
3           volatile market environment, as recently evidenced during the COVID-19  
4           pandemic. Utilities with higher credit ratings are associated with reduced risk,  
5           which attracts investors at a lower cost of debt (e.g., lower average credit spreads)  
6           and favorably position a utility relative to lower-rated comparable companies.  
7           The stronger SPS's credit ratings, the larger the pool of investors willing to  
8           consider investing in SPS's debt and the lower the coupon rate<sup>7</sup> SPS will need to  
9           pay in order to issue debt. Investment-grade credit ratings are crucial because the  
10          cost of debt increases very rapidly – and the number of potential buyers decreases  
11          substantially – for those companies rated near the bottom of or below investment  
12          grade. Credit ratings take on greater importance when economic conditions  
13          worsen and credit becomes more difficult to obtain. As credit availability  
14          tightens, investors become increasingly selective regarding which companies  
15          qualify for their investment dollars. Therefore, lower credit ratings reduce access  
16          to capital markets and increase the expense of obtaining capital.

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<sup>7</sup> The coupon rate is the rate of interest paid by bond issuers on the bond's face value. A bond is priced at the underlying Treasury rate plus a credit spread.

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1           Equity investors also look at credit ratings as a source of information they  
2           rely on to differentiate between utilities. Because the income available to  
3           common equity holders is subordinate to debt obligations, the weakening of a  
4           company's creditworthiness also increases the cost of equity. As Mr. D'Ascendis  
5           explains, bond and credit ratings are reflective of the types of risks faced by debt  
6           holders, and lower credit ratings generally correspond to higher required returns  
7           on equity to compensate for higher risk.<sup>8</sup>

8           Ultimately, customers of the higher-rated utility benefit from lower capital  
9           costs, as these costs are borne by customers.

10   **Q. Do credit ratings affect SPS's cost of capital?**

11   A. Yes. Long-term debt is priced based on the underlying Treasury rate plus a credit  
12           spread, which is primarily based on SPS's credit rating. In general, the lower the  
13           credit rating, the higher the credit spread. Issuing debt at a higher rate will  
14           increase the long-term cost of debt for SPS and ultimately increase the cost of  
15           debt paid for by SPS's customers.

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<sup>8</sup> Mr. D'Ascendis' recommended upward adjustment to SPS's return on equity due to SPS's relative riskiness illustrates this principle. See Mr. D'Ascendis' direct testimony at 82.

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1 **Q. Do credit spreads differ based on credit ratings?**

2 A. Yes. As discussed above, lower credit ratings are seen as riskier and therefore  
3 investors demand a higher spread. Chart PLM-2 below shows that the credit  
4 spreads of BBB rated utility companies are historically wider than those of A  
5 rated utility companies, especially in times of market volatility. This chart  
6 demonstrates that although in current market conditions the credit spread between  
7 A and BBB ratings is approximately 30 basis points,<sup>9</sup> in periods of more severe  
8 market volatility, such as June 2009, the credit spread increased dramatically, at  
9 an average spread of 100 basis points. More recently, in March 2020, the credit  
10 spread increased at an average spread of 75 basis points due to the COVID-19  
11 pandemic. Under such conditions a BBB rated utility, such as SPS, would pay an  
12 additional \$750,000 of interest annually above what an A rated utility would pay  
13 for every \$100 million issued in debt. For a 30-year bond, this equates to an  
14 additional \$22.5 million of interest over the life of the bond.

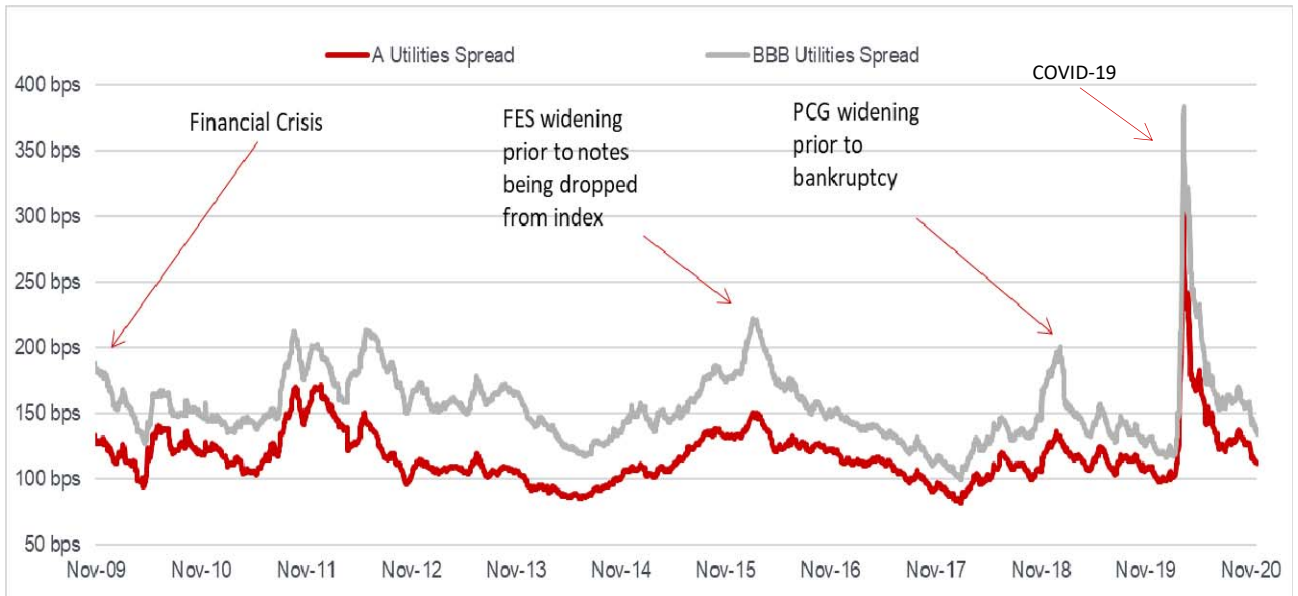
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<sup>9</sup> Based on average spread for November 2020. Source: Bloomberg.

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1  
2

**Chart PLM-2**  
**A vs. BBB Rated Utility Spreads**



3

4 **Q. Why is it important for SPS to maintain an investment grade credit rating?**

5 A. Maintaining investment grade credit ratings is important because many  
6 institutional investors are not permitted to purchase non-investment grade  
7 securities (lower than Baa3 for Moody's and BBB- for S&P and Fitch Ratings  
8 ("Fitch")). Institutional investors include banks, insurance companies, pension  
9 funds, endowments, and mutual funds that invest money on behalf of individuals  
10 or other institutions. These types of investors are critically important to the market  
11 and to SPS. Institutional investors own substantially all of SPS's outstanding

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1 bonds, and it is critically important for SPS and its customers that institutional  
2 investors be allowed to own SPS's debt instruments in order to maximize access  
3 to capital. In times of capital scarcity, companies with lower than investment  
4 grade ratings may not have access to capital at any cost. As described below, in  
5 times of market volatility the capital markets have effectively been closed except  
6 to those with stellar credit ratings. SPS's continued provision of safe and reliable  
7 electric delivery in all market conditions thus depends on having the type of  
8 financial health that will allow it to access cash on reasonable terms when it needs  
9 it most.

10 **Q. Why should the Commission be concerned about SPS's financial integrity?**

11 A. Financial integrity directly affects SPS's ability to access capital and the cost of  
12 that capital, which, in turn, impacts the cost of debt and the cost of equity that  
13 must be paid by customers and SPS's ability to fund new projects. The ability to  
14 attract capital at a reasonable cost in all market conditions is critical for SPS to  
15 satisfy its obligation to provide safe and reliable utility service, as it helps ensure  
16 that SPS has the flexibility to withstand unanticipated macroeconomic events  
17 outside of its control. In contrast, a company with weaker financial integrity will  
18 be limited in its ability to finance assets or undertake new projects, particularly

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1 during times of volatility in the capital markets. Weak financial integrity at a  
2 utility also increases the issued cost of debt and the implied cost of equity, which  
3 increases the overall WACC and the ultimate financing costs which are paid by  
4 customers.

5 **Q. Is the outcome of this case important to how investors will view SPS's**  
6 **ongoing financial integrity?**

7 A. Yes. This case is particularly important for several reasons. First, this case  
8 provides an opportunity to build on the recent constructive rate case settlement,  
9 which was a positive first step toward alleviating ratings agency concerns  
10 regarding SPS's regulatory environment. Second, SPS currently (and for the  
11 foreseeable future) has the need to raise outside capital (both equity and debt) to  
12 support investment necessary to: (1) serve the economic expansion in SPS's  
13 service territory; and (2) enable customer-benefitting clean-energy initiatives.  
14 Consequently, rating agencies will be looking at the Commission's decision in  
15 this case as an indication of whether New Mexico is continuing to move toward a  
16 more balanced and constructive regulatory environment that complements and  
17 supports the State's priorities of economic growth and clean and affordable  
18 electricity.

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1 **Q. Please address the credit rating downgrade of SPS in 2018.**

2 A. In the fourth quarter 2018, Moody’s, which rates SPS on a stand-alone basis  
3 (rather than as part of the Xcel Energy “family”), downgraded SPS’s credit  
4 ratings, as reflected in Table PLM-3 below.

5 **Table PLM-3**

<b>Moody’s Ratings</b>	<b>Current Rating<sup>10</sup></b>	<b>Prior Rating</b>
Issuer Rating	Baa2	Baa1
Senior Secured-FMB	A3	A2
Commercial Paper	P-2	P-2

6 This deterioration in SPS’s credit ratings was partially due to concern with  
7 the regulatory environment and the lack of regulatory support that SPS was  
8 experiencing in New Mexico.<sup>11</sup> SPS’s most recent rate case stipulation, however,  
9 was viewed by ratings agencies as a positive first step toward improving SPS’s  
10 credit risk. For instance, Moody’s stated that “the stipulation is credit positive for  
11 SPS because it indicates the utility’s improving relationship with stakeholders in  
12 New Mexico.”<sup>12</sup> This case represents an opportunity to build on the prior

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<sup>10</sup> Attachment PLM-1 at 1.

<sup>11</sup> Attachment PLM-1 at 1.

<sup>12</sup> Attachment PLM-2 at 1.



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1 settlement and support the view of a more constructive regulatory environment.  
2 As Mr. Shipman explains, the regulatory environment is the single most important  
3 factor in the assessment of a utility's business risk. Continuing to improve  
4 investor opinion is important to managing future funding costs to ensure that  
5 SPS's generation resources and transmission and distribution system can safely  
6 and reliably meet long-term growth requirements.

7 **Q. Will the capital structure and ROE authorized in this proceeding affect**  
8 **SPS's ability to access capital at reasonable rates?**

9 A. Yes. The authorized capital structure and ROE directly affects SPS's ability to  
10 fund its operations with internally generated funds. Because investors and rating  
11 agencies are concerned with the extent to which capital investments are funded  
12 with external capital (i.e. overall level of debt in the capital structure) as opposed  
13 to internally generated funds, both the capital structure and ROE established by  
14 the Commission in this proceeding will be of significant concern to the financial  
15 community.

16 It is also important to realize that because a utility's investment horizon is  
17 very long, investors require the assurance of a sufficient return to satisfy the long-  
18 run financing requirements of the assets it puts into service. Debt investors

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1 require assurance that they will receive scheduled interest payments over the life  
2 of their investment as well as the eventual return of principal. Those assurances,  
3 which often are measured by the relationship between internally generated cash  
4 flows and debt (or interest expense), depend heavily on the capital structure, as  
5 capital structure determines the amount of debt to be serviced and also influences  
6 the level of internal cash flow being generated. Consequently, both capital  
7 structure and ROE are critical to debt and equity investors.

8 **C. SPS's Financial Integrity and Credit Metrics**

9 **Q. What topics do you discuss in this section of your testimony?**

10 A. I describe assessments of SPS's financial integrity, including as specified through  
11 its credit ratings, and explain how they have changed over time.

12 **Q. What are SPS's current credit ratings?**

13 A. SPS currently has a corporate credit rating of A- from S&P and BBB from both  
14 Moody's and Fitch, as reflected in Table PLM-4 below.

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1

**Table PLM-4**

	<b>S&amp;P<sup>13</sup></b>	<b>Moody's</b>	<b>Moody's S&amp;P Equivalent</b>	<b>Fitch</b>
Corporate Rating	A-	Baa2	BBB	BBB
Senior Secured	A	A3	A-	A-
Stand-alone Credit Profile (SACP)	BBB+	N/A	N/A	N/A
Commercial Paper	A-2	P-2	N/A	F2

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As discussed above, Moody's downgraded SPS's credit ratings in 2018. S&P has not taken action on SPS's corporate credit ratings, in part because SPS benefits from "family style" ratings by S&P; meaning, the issuer credit rating for SPS is equal to Xcel Energy's group credit profile, and is therefore benefitted by SPS having sister utilities that operate in regulatory environments that investors view as relatively more supportive. S&P also assigns what is referred to as a Stand-alone Credit Profile ("SACP"). The SACP is an intermediate determination in S&P's ratings methodology that signifies what an issuer's rating would be absent extraordinary parental support.<sup>14</sup> The SACP for SPS was

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<sup>13</sup> Based on the S&P "family style" rating. The SACP for SPS is one notch lower than the Corporate Rating of A- as discussed below.

<sup>14</sup> Attachment PLM-3 at 7-9.

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1 lowered in November 2018 to BBB+, around the same time as the Moody's  
2 downgrade,<sup>15</sup> and is one notch lower than the Corporate Rating of A-.

3 **Q. Does a lower credit rating have impacts that extend beyond the long-term**  
4 **cost of debt?**

5 A. Yes. A downgrade could also affect SPS's cost of daily business or access to its  
6 short-term liquidity. The daily business of SPS is comprised of ongoing credit  
7 facility fees, letters of credit to support utility operations, and commercial paper  
8 rates. If SPS were downgraded such that it lost its A2/P2/F2 commercial paper  
9 rating, SPS would need to borrow directly from its \$500 million credit facility and  
10 pay up to 125 basis points higher than its current commercial paper rate,<sup>16</sup> which  
11 translates to approximately \$1.25 million in additional annual debt expense for  
12 every \$100 million borrowed directly from the revolver, given the current rate  
13 environment. Credit enhancement products that SPS uses in the normal course of  
14 business, such as letters of credit, similarly become more expensive as the credit  
15 rating deteriorates.

16 As an example, during the financial crisis in 2007/2008, even though SPS  
17 still had its A2/P2 commercial paper rating, SPS was forced to borrow against its

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<sup>15</sup> Attachment PLM-4 at 4-5.

<sup>16</sup> SPS 30 day commercial paper rate as of November 18, 2020 was 0.24% vs. the drawn revolver pricing of 3-month LIBOR plus 1.25% (0.23% + 1.25% = 1.48%)

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1 credit facility rather than issuing commercial paper due to extreme market  
2 volatility. SPS borrowed \$125 million against its then \$250 million credit facility  
3 at a cost of approximately 6%. The only companies that retained reasonably-  
4 priced access to short-term commercial paper markets during October 2007 were  
5 companies with short-term ratings of A1/P1.

6 **Q. Can you provide a recent example of volatility that impacted the capital**  
7 **markets?**

8 A. Yes. Most recently, the COVID-19 outbreak introduced extreme volatility into the  
9 market and made it challenging for companies to access capital. For instance,  
10 credit spreads widened in early March 2020, with lower rated credits seeing the  
11 biggest move as shown in Table PLM-5 below:<sup>17</sup>

12 **Table PLM-5**

<b>Rating</b>	<b>Increase in Spread<sup>18</sup></b>
AA	+22 bps
A	+24 bps
BBB	+35 bps

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<sup>17</sup> Bank of America Merrill Lynch (BAML) Master Spread Index, March 3, 2020.

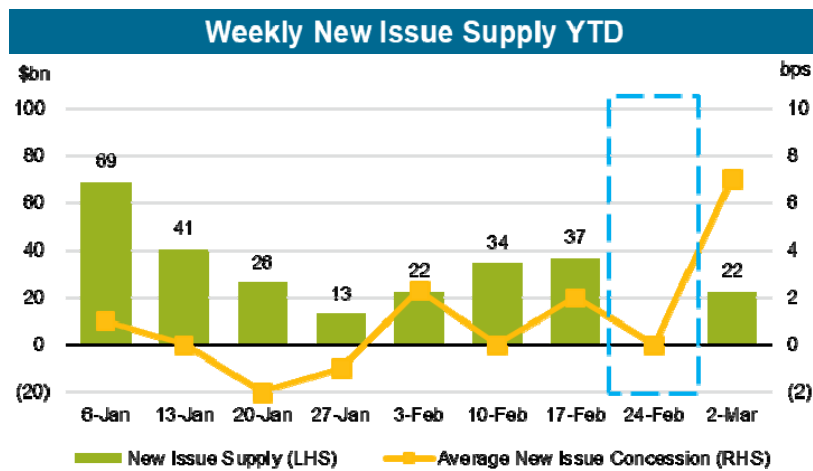
<sup>18</sup> Debt securities are priced based on the underlying Treasury rate plus a credit spread. Credit spreads vary from one security to another based on the credit rating of the issuer of the bond. Higher credit ratings typically result in lower credit spreads, due to lower perceived risk of default. Conversely, lower credit ratings typically result in higher credit spreads, due to the higher perceived risk of default.

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1 **Q. How did this recent market volatility impact the ability of companies to**  
2 **access the market?**

3 A. Due to the extreme market volatility, the investment grade markets were  
4 inaccessible the week of February 24, 2020, with no issuances coming to market,  
5 as shown in Chart PLM-3 below.

6 **Chart PLM-3: Weekly New Issue Supply YTD March 2, 2020<sup>19</sup>**



7  
8 Investment grade issuers were not willing to issue given the unpredictable  
9 market and pricing risk. The following week, while some issuers were able to  
10 access the markets and issue \$22 billion of debt, the cost to issue that debt was  
11 elevated. This illustrates the importance of maintaining financial integrity in  
12 order to manage through all market conditions, as companies with higher credit

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<sup>19</sup> Source: Bloomberg.

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1 ratings have more financial flexibility to manage through extreme market  
2 conditions, such as the recent disruption.

3 As Mr. D’Ascendis describes in his direct testimony, The Federal Reserve  
4 and the U.S. government have implemented multiple policies to address the  
5 financial market and economic instability as a result of COVID-19 in order to  
6 help stabilize markets. A lack of liquidity froze markets and spurred The Federal  
7 Reserve into various credit facilities, which were meant to support market  
8 functioning and enhance the flow of credit to the economy. The Federal Reserve  
9 recently extended several pandemic emergency lending programs, with U.S.  
10 Treasury Department approval, for three months through March 31, 2021.<sup>20</sup> This  
11 continued intervention demonstrates the severity of the market risk imposed by  
12 the COVID-19 pandemic and continued strain and vulnerability of the economy  
13 in its wake.

14 **D. Maintaining and Strengthening SPS’S Financial Integrity**

15 **Q. Have you assessed SPS’s financial metrics at the requested capital structure**  
16 **to determine if these metrics are sufficient to maintain the current credit**  
17 **ratings?**

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<sup>20</sup> Federalreserve.gov press release dated 11.30.2020 titled “Federal Reserve Board announces extension through March 31, 2021, for several of its lending facilities that were generally scheduled to expire on or around December 31.”

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1 A. Yes. With a 54.72% regulated equity ratio, the FFO/Debt ratios continue to  
2 support the A- current rating under S&P's methodology. The Debt/EBITDA  
3 ratios, however, as shown on Table PLM-6, are outside of the range for an A-  
4 rating, indicating a lower rating.

5 **Table PLM-6:**  
6 **S&P Metrics at 54.72% Regulated Equity Ratio**

<b>A Corp. Rating Medial Volatility</b>	<b>S&amp;P Guidelines</b>	<b>Actual 2018</b>	<b>Actual 2019</b>	<b>Forecast 2020</b>	<b>Forecast 2021</b>	<b>Forecast 2022</b>
<b>FFO/Debt *</b>	<b>no less than 15%</b>	18.3%	18.4%	<i>17.5%</i>	<i>17.7%</i>	<i>18.2%</i>
<b>Debt/EBITDA**</b>	<b>no more than 3.5-4.5</b>	4.4x	4.6x	<i>4.7x</i>	<i>4.7x</i>	<i>4.7x</i>
<b>FFO/Interest</b>	<b>No less than 3-5</b>	5.4x	5.5x	<i>5.3x</i>	<i>5.3x</i>	<i>5.5x</i>
<b>EBITDA/Interest</b>	<b>No less than 2.75-5</b>	5.4x	5.4x	<i>5.2x</i>	<i>5.1x</i>	<i>5.2x</i>

\* (Funds from Operations/Total Debt including adjustments)

\*\* (Debt including adjustments/Earnings before interest taxes depreciation and amortization)

7 **Q. What are the projected metrics under Moody's methodology?**

8 A. Financial metrics account for 40% of Moody's methodology grid. Assuming a  
9 54.72% regulated equity ratio, the resulting credit metrics put SPS solidly on



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1 target to maintain its current Baa2 rating and supports progress toward regaining a  
2 higher credit rating. As Mr. Shipman discusses, even at the full capital structure  
3 ask in this case, it is not sufficient to regain the former Baa1 rating unless  
4 sustained, constructive regulatory outcomes are achieved.

**Table PLM-7:**

**Moody's Debt Metrics at 54.72% Regulated Equity Ratio**

<b>Guidelines for Baa2 Corp. Rating</b>	<b>Moody's Guidelines</b>	<b>Moody's 2018</b>	<b>Actual 2019</b>	<b>Forecast 2020</b>	<b>Forecast 2021</b>	<b>Forecast 2022</b>
<b>CFO pre WC /Debt*</b>	<b>no less than 15%</b>	18.6%	18.1%	<i>18.4%</i>	<i>18.3%</i>	<i>18.7%</i>
<b>CFO pre-WC/Interest**</b>	<b>no less than 3x – 4.5x</b>	5.8x	5.4x	<i>5.7x</i>	<i>5.6x</i>	<i>5.8x</i>
<b>CFO pre-WC-Div/Debt***</b>	<b>no less than 9 – 17%</b>	13.0%	5.1%	<i>11.7%</i>	<i>11.5%</i>	<i>12.1%</i>

\* (Cash from Operations before working capital/Debt). SPS threshold for downgrade is 15% per Moody's report

\*\* (Cash from Operations before working capital plus interest/interest)

\*\*\* (Cash from Operations before working capital-Dividends/Debt)

7 **Q. What is an economic capital structure and how does it impact credit metrics?**

8 A. As Mr. Shipman discusses, the credit rating agencies make certain adjustments for  
9 off-balance sheet items and impute these adjustments as additional debt when

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1 calculating credit metrics. Examples of these adjustments are for purchase power  
2 commitments, leases, underfunded pension obligations and asset retirement  
3 obligations. A company's "economic" capital structure includes the consideration  
4 of these items.

5 SPS has a number of off-balance sheet obligations that the rating agencies  
6 include in their analysis of credit metrics. During 2019, S&P identified \$358.5  
7 million of debt adjustments for off-balance sheet items for SPS, of which  
8 approximately 75% were for purchased power agreements and operating leases.  
9 After those off-balance sheet obligations are taken into account, the actual  
10 economic equity ratio considered by the rating agencies is far lower than the  
11 regulated equity ratio. For example, a regulated equity ratio of 54.72% translates  
12 to an economic equity ratio of 51.27% under S&P's methodology. The regulated  
13 equity ratio thus understates the true leverage considered by credit rating agencies  
14 because it excludes off balance sheet items as well as short-term debt.

15 **Q. Why is it important for the Commission to consider the economic capital**  
16 **structure in its decision in this case?**

17 A. Because rating agency analyses include the additional imputed debt for the items  
18 mentioned above as well as short-term debt, the economic equity ratio will always  
19 be lower than the authorized regulated equity ratio. The Commission should set

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1 an authorized equity ratio that will be sufficient to maintain credit ratings after the  
2 rating agency adjustments have been made.

3 **Q. Why is it important for SPS to maintain its A-/BBB corporate rating?**

4 A. First, SPS has been able to maintain the A- rating from S&P because S&P  
5 analyzes the Xcel Energy family in its entirety to assess the overall credit risk.  
6 All operating companies and Xcel Energy have A- corporate ratings from S&P.  
7 SPS's corporate credit rating at BBB by both Moody's and Fitch, however, is the  
8 lowest in the Xcel Energy family, lower than the Moody's and Fitch credit ratings  
9 for the Xcel Energy holding company at Baa1 and BBB+, respectively. A one  
10 notch downgrade by Moody's or Fitch at SPS would result in a BBB- equivalent  
11 rating, just one notch away from junk bond status. A downgrade would not only  
12 increase SPS's borrowing costs, but would bring SPS nearer to the financially  
13 harmful results associated with the loss of investment grade credit.

14 Dr. Roger Morin, a noted expert on regulatory finance, analyzes the  
15 optimal capital structure for utilities in his book *New Regulatory Finance*. Based  
16 on that analysis, Dr. Morin concludes that an A rated utility is in the best interest  
17 of the customers and utilities:

18 The message from the model is clear: over the long run, a strong A  
19 bond rating will minimize the pre-tax cost of capital to ratepayers.

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1 Long term achievement of at least an A rating is in the electric  
2 utility company's and ratepayers' best interests.

3 . . . .

4 The model results show that on an incremental cost basis, a strong  
5 A bond rating generally results in the lowest pre-tax cost of capital  
6 for electric utilities, especially under adverse economic conditions,  
7 which are far more relevant to the question of capital structure.<sup>21</sup>

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<sup>21</sup> Roger A. Morin, *New Regulatory Finance*, Public Utilities Report, Inc., at 515 (2006).

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1 **IV. CAPITAL STRUCTURE**

2 **Q. What is SPS's Base Period capital structure and cost of capital?**

3 A. The Base Period capital structure and cost of debt as of September 30, 2020 are  
4 shown in Table PLM-8. The detailed schedules are included in Schedule A-5.

5 **Table PLM-8**

		<b>September 30, 2020</b>	
	<b>Ratio</b>	<b>Rate</b>	<b>Wtd. Cost</b>
Long-Term Debt	45.28%	4.31%	1.95%
Equity	54.72%	9.45% <sup>22</sup>	5.17%
<b>Total Cost</b>			<b>7.12%</b>

6 **Q. What is SPS's proposed Test Year capital structure and cost of capital?**

7 A. SPS's proposed Test Year WACC is 7.61% as shown below in Table PLM-9.  
8 The Test Year WACC is based on an authorized ROE of 10.35%, a long-term  
9 debt cost of 4.31%, and a capital structure composed of 54.72% common equity  
10 and 45.28% long-term debt.

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<sup>22</sup> Authorized ROE of 9.45% was established in Case No. 19-00170-UT. To be clear, this is not the actual earned ROE for the period, as it does not reflect the effect of additional investments and additions to rate base.

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1

**Table PLM-9**

		<b>Proposed Test Year WACC</b>	
	<b>Ratio</b>	<b>Rate</b>	<b>Wtd. Cost</b>
Long-Term Debt	45.28%	4.31%	1.95%
Equity	54.72%	10.35%	5.66%
<b>Total Cost</b>			<b>7.61%</b>

2 **Q. What capital structure is SPS seeking in this case?**

3 A. SPS seeks a capital structure consisting of 54.72% equity and 45.28% long-term  
4 debt, which is similar to the currently-authorized capital structure of 54.77%  
5 equity and 45.23% debt.

6 **Q. Does this capital structure reflect SPS's actual financing practices?**

7 A. Yes. SPS maintains a capital structure consisting of 54.72 equity and 45.28 long  
8 term debt.

9 **Q. Is it important that the Commission adopt a capital structure that reflects**  
10 **SPS's actual financing practices?**

11 A. Yes. As noted earlier, it is important that the Commission adopt a capital  
12 structure that reflects SPS's actual financing practices. As Mr. D'Ascendis  
13 explains, the imposition of a hypothetical capital structure that understates SPS's  
14 actual capital structure will weaken the financial condition of its operations and

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1 adversely impact SPS's ability to address expenses and investments, to the  
2 detriment of customers and shareholders. This results from the fact that as more  
3 debt is introduced into the capital structure, the company becomes more  
4 financially risky, which in turn increases the equity returns demanded by  
5 investors.<sup>23</sup> Thus, an attempt to reduce the overall cost of capital by increasing  
6 the amount of debt in the capital structure can actually produce the opposite of the  
7 intended effect.

8 **Q. Have you assessed the reasonableness of the requested equity ratio?**

9 A. Yes. For the reasons explained in my testimony and in Mr. D'Ascendis' direct  
10 testimony, SPS's requested 54.72% equity ratio will reasonably support SPS's  
11 current credit rating and will provide flexibility in financing its operations and  
12 capital expenditures in all economic conditions.

13 **Q. Why is SPS requesting that the Commission allow the equity ratio to exceed**  
14 **55% for up to 90 days?**

15 A. In May 2009, as part of the Uncontested Comprehensive Stipulation in Case No.  
16 08-00354-UT, the Commission established an equity range for SPS of +/- 5% of  
17 50%, which capped the equity component at 55%.<sup>24</sup> It was further stipulated that

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<sup>23</sup> See, e.g., Morin, *New Regulatory Finance* at 25 (2006).

<sup>24</sup> Case No. 08-00354-UT, Uncontested Comprehensive Stipulation at 15-16.

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1 SPS would request authorization from the Commission before changing its  
2 common equity target or range.

3 Today, SPS maintains its regulated equity ratio at or near the currently  
4 authorized level of 54.77%. Maintaining the equity ratio between the current  
5 authorized equity ratio of 54.77% and at or below the 55% equity cap is  
6 challenging from a cash management perspective, leaving little room for any  
7 difference between SPS's forecast and its actual results.

8 **Q. Please describe in more detail the requested 90-day cap flexibility that SPS is**  
9 **requesting.**

10 A. SPS requests the flexibility to issue securities or infuse additional equity when  
11 needed, not to exceed the stated 55% for more than 90 days, without preapproval  
12 from the Commission. SPS believes that while use of its actual capital structure is  
13 appropriate for setting rates, a modest amount of additional flexibility above the  
14 current 55% cap will provide SPS the opportunity to more efficiently manage  
15 cash. If for any reason it saw a need to manage the equity ratio above 55% for a  
16 period of more than 90 days, SPS agrees to request approval from the  
17 Commission.

18 Please note that SPS is not asking for an increase in earned return on the  
19 equity ratio if it exceeds 54.72% for any period of time. SPS simply requests the



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1 ability to maintain the equity ratio above 54.72% if needed, in order to manage its  
2 capital structure efficiently and in accordance with best cash management  
3 practices.



**BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION**

**IN THE MATTER OF SOUTHWESTERN )  
PUBLIC SERVICE COMPANY'S )  
APPLICATION FOR: (1) REVISION OF )  
ITS RETAIL RATES UNDER ADVICE )  
NOTICE NO. 292; (2) AUTHORIZATION )      **CASE NO. 20-00238-UT**  
AND APPROVAL TO ABANDON ITS )  
PLANT X UNIT 3 GENERATING )  
STATION; AND (3) OTHER )  
ASSOCIATED RELIEF, )  
SOUTHWESTERN PUBLIC SERVICE )  
COMPANY, )  
APPLICANT. )**

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**VERIFICATION**

On this day, December 30, 2020, I, Patricia L. Martin, swear and affirm under penalty of perjury under the law of the State of New Mexico, that my testimony contained in Direct Testimony of Patricia L. Martin is true and correct.

*/s/ Patricia L. Martin*  
\_\_\_\_\_  
PATRICIA L. MARTIN

# MOODY'S

## INVESTORS SERVICE

### Rating Action: Moody's changes Xcel Energy's outlook to negative; downgrades Southwestern Public Service ratings to Baa2 with stable outlook

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19 Oct 2018

#### Approximately \$19 billion of debt securities affected

New York, October 19, 2018 -- Moody's Investors Service ("Moody's") changed the rating outlook of Xcel Energy Inc. (Xcel) to negative from stable and affirmed the A3 senior unsecured and Prime-2 short-term rating for commercial paper ratings.

At the same time, Moody's downgraded the long-term ratings of Southwestern Public Service Company (SPS) including the Issuer rating to Baa2 from Baa1 and affirmed SPS' P-2 short-term rating. The outlook for SPS was changed to stable from negative.

Moody's also affirmed the ratings and outlooks of the Xcel other rated subsidiaries: Northern States Power Company (Minnesota) (NSP-Minnesota, A2 stable), Public Service Company of Colorado (PSCO, A3 stable), and Northern States Power Company (Wisconsin) (NSP-Wisconsin, A2 stable).

#### RATINGS RATIONALE

"Xcel Energy's financial ratios will be lower for longer due to the cash flow leakage associated with tax reform and an elevated investment program primarily funded with debt" said Natividad Martel, Vice President - Senior Analyst. "The negative outlook reflects consolidated cash flow to debt ratios falling to the 16%-17% range over the next few years, down from around 20% over the last several years."

Xcel's A3 rating factors the group's fully regulated operations and its geographic and operational diversity benefits, as well as our view that the eight regulatory jurisdictions in which its four utility subsidiaries operate are overall credit supportive. The rating considers Xcel's improving carbon transition risk exposure, with an accelerating "steel for fuel" program where the company is replacing fossil-fired generation with renewable generation. The rating also factors in the \$300 million equity issuance initiated September 2018 and the structurally subordinated position of the parent level debt vis-à-vis the debt outstanding at its utility subsidiaries, with holding company debt relative to total consolidated debt expected to remain below 25% (currently around 22%).

#### Southwestern Public Service Company (SPS)

The downgrade of SPS' ratings reflects a weakening in the utility's credit metrics, such that its ratio of CFO pre-W/C to debt is anticipated to drop to nearly 16% by next year, a material deterioration compared to the 22% ratio that SPS generated for the last twelve month period ended 30 June 2018. SPS' Baa2 rating and stable outlook incorporate the expectation that its CFO pre-W/C to debt ratio will remain in the 16%-17% range over the foreseeable future. The Baa2 rating considers our mixed view of the credit supportiveness of the regulatory environments under which SPS operates. Moody's sees more constructive recovery mechanisms available in Texas than in New Mexico, illustrated by the different regulators' responses to the utility's initiatives to offset the impact of the implementation of the TCJA. In Texas, the regulators approved the multi-party settlement that included authorization to earn a 9.5% rate on equity (ROE) on SPS' actual capital structure, which the utility anticipates will include an above average 57% equity layer. In contrast, the New Mexico Regulatory Commission approved, in September 2018, an increase in SPS' base rates (\$8 million) based on a 51% equity ratio, a significant difference compared to SPS' requested 58% equity ratio. This request was updated post-tax reform, and could be indicating a less constructive relationship between the utility and the NMPRC. The combination of the utilities' investment program along with the exposure of its cash flows to regulatory lag, particularly due to the absence of any transmission and distribution riders in New Mexico, contribute to the extended deterioration in the utility's financial profile.

#### NSP-Minnesota, PSCO and NSP-Wisconsin

The affirmation of the ratings of NSP-Minnesota (A2, stable), NSP-Wisconsin (A2 stable) and PSCO (A3 stable) consider our view that all three utilities maintain a reasonably constructive relationship with their

respective regulators. The rating affirmations incorporate the expectation that the outcomes of pending regulatory decisions, including the need to address tax reform cash flows, will be a net credit positive. In some states, these measures include the deferral of portions of the excess deferred tax liabilities (EDTL) to be refunded to end-users. In Colorado, PSCO was allowed to amortize prepaid pension assets as an offset of refunds in 2018 and 2019. PSCO has also requested an increase in its the equity ratio to 56% in the Colorado natural gas TCJA true-up proceeding with the decision expected later this year. The stable outlooks assume that these regulatory initiatives along with the reduction in the utilities' base case investments will help to partially mitigate the anticipated weakening in the credit metrics. Importantly, the stable outlooks also assume that each of these utilities will continue to generate CFO pre-W/C to debt in excess of 20%, on a sustained basis.

#### WHAT CAN CHANGE THE RATING - DOWN

Xcel's ratings could be downgraded if the consolidated ratio of CFO pre-W/C to debt remains below 18% for a sustained basis, or there is no transparent path to improve the ratio over the next few years. The ratings of NSP-Minnesota, NSP-Wisconsin, PSCO and SPS could be downgraded if we perceive a deterioration in the credit supportiveness of their regulatory environments, or if their credit metrics deteriorate more than currently anticipated. Specifically, downward pressure on the ratings of NSP-Minnesota and NSP-Wisconsin could result if their CFO pre-W/C to debt ratios fall to the low 20% range, for an extended period.

In the case of PSCO and SPS, producing CFO pre-W/C to debt below 20% and 16%, respectively, on a sustained basis, is also likely to result in a downgrade of their ratings.

#### WHAT CAN CHANGE THE RATING - UP

Given Xcel's negative outlook, there are limited prospects for a near term upgrade. However, the outlook could be stabilized if we see a clear path for Xcel to record again CFO pre-W/C to debt in excess of 18%, on a sustained basis.

Positive momentum on the ratings of NSP-Minnesota, NSP-Wisconsin, PSCO and SPS is also unlikely given our expectation that their weakening credit metrics will result in their credit profiles to be commensurate with their current ratings. Longer term, the utilities' ratings could experience positive momentum if higher than anticipated regulatory relief and/or cost savings allow them to record CFO pre-W/C to debt in the high 20% in the case of NSP-Minnesota and NSP-Wisconsin, 25% in the case of PSCO, and 18% in the case of SPS.

#### Downgrades:

..Issuer: Southwestern Public Service Company

.... Issuer Rating, Downgraded to Baa2 from Baa1

....Senior Secured Shelf, Downgraded to (P)A3 from (P)A2

....Senior Unsecured Shelf, Downgraded to (P)Baa2 from (P)Baa1

....Senior Secured First Mortgage Bonds, Downgraded to A3 from A2

....Senior Unsecured Bank Credit Facility, Downgraded to Baa2 from Baa1

....Senior Unsecured Regular Bond/Debenture, Downgraded to Baa2 from Baa1

#### Outlook Actions:

..Issuer: Northern States Power Company (Minnesota)

....Outlook, Remains Stable

..Issuer: Northern States Power Company (Wisconsin)

....Outlook, Remains Stable

..Issuer: Public Service Company of Colorado

....Outlook, Remains Stable

..Issuer: Southwestern Public Service Company

...Outlook, Changed To Stable From Negative

..Issuer: Xcel Energy Inc.

...Outlook, Changed To Negative From Stable

Affirmations:

..Issuer: La Crosse (City of) WI

...Senior Unsecured Revenue Bonds, Affirmed A2

..Issuer: Northern States Power Company (Minnesota)

... Issuer Rating, Affirmed A2

...Senior Unsecured Shelf, Affirmed (P)A2

...Senior Secured Shelf, Affirmed (P)Aa3

...Senior Secured First Mortgage Bonds, Affirmed Aa3

...Underlying Senior Secured First Mortgage Bonds, Affirmed Aa3

...Senior Unsecured Bank Credit Facility, Affirmed A2

...Senior Unsecured Commercial Paper, Affirmed P-1

..Issuer: Northern States Power Company (Wisconsin)

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...Senior Secured Shelf, Affirmed (P)Aa3

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..Issuer: Xcel Energy Inc.

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....Subordinate Shelf, Affirmed (P)Baa1  
....Preferred Shelf, Affirmed (P)Baa2  
....Junior Subordinate Shelf, Affirmed (P)Baa1  
....Senior Unsecured Bank Credit Facility, Affirmed A3  
....Senior Unsecured Commercial Paper, Affirmed P-2  
....Senior Unsecured Regular Bond/Debenture, Affirmed A3

The principal methodology used in these ratings was Regulated Electric and Gas Utilities published in June 2017. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

Xcel Energy Inc. (Xcel) is a holding company for vertically integrated utility subsidiaries, namely Northern States Power Company (Minnesota) (NSP-Minnesota, A2 stable), Public Service Company of Colorado (PSCO, A3 stable), Southwestern Public Service Company (SPS, Baa2 stable), and Northern States Power Company (Wisconsin) (NSP-Wisconsin, A2 stable). These subsidiaries serve 3.6 million electric and 2.0 million natural gas customers in eight states, but mostly in Minnesota, Colorado, New Mexico, Texas, and Wisconsin.

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## ISSUER COMMENT

17 January 2020

✓ Rate this Research

### RATINGS

#### Southwestern Public Service Company

Domicile	Amarillo, Texas, United States
Long Term Rating	Baa2
Type	LT Issuer Ratings
Outlook	Stable

Source: Moody's Investors Service

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## Southwestern Public Service Company

### Southwestern Public Service's rate-case stipulation agreement in New Mexico is credit positive

On 13 January, [Southwestern Public Service Company](#) (SPS, Baa2 stable) asked the New Mexico Public Regulatory Commission (NMPRC) to approve a comprehensive stipulation agreement it entered with several intervenors, including the NMPRC staff, on the terms of its pending rate case. The stipulation is credit positive for SPS because it indicates the utility's improving relationship with stakeholders in New Mexico.

SPS' retail operations rate base case in New Mexico represents around 25% of the utility's total rate base. Incremental cash flows resulting from the stipulation, if approved, will support the utility's financial performance. Texas, where the utility also has a rate case pending, accounts for over 50% of the total. SPS' wholesale production and transmission operations, which are subject to the Federal Energy Regulatory Commission, accounts for the balance.

We assume credit-supportive outcomes in the utility's pending rate cases in both New Mexico and Texas, which will make SPS' cash flow from operations before changes in working capital (CFO pre-W/C) to debt ratio 16%-18% over the foreseeable future.

If implemented, the terms of the stipulation agreement would allow the utility to increase its base rates by \$31 million, more than 60% of its final rate increase request of around \$47 million. The parties agreed that SPS' authorized equity ratio should be the utility's requested equity layer of 54.77%. This ratio is 80 basis points higher than the utility's current allowed equity layer of 53.97%, which would strengthen the utility's balance sheet. However, the positive effect on the utility's cash flows would be partially offset by an 11 basis point reduction in the NMPRC authorized return on equity (RoE) to 9.45% from the 9.56% since February 2019.

We estimate that the difference between the utility's requested RoE of 10.35% and the 9.45% RoE included in the stipulation accounts for around one third (or around \$5 million) of the \$16 million gap between the utility's requested rate increase and the \$31 million settlement.

The parties also agreed on the early retirement of the Tolk coal-fired facility in 2037 and the recovery of its accelerated rate depreciation. SPS already has authority in Texas to retire the plant's two generating units in 2037, compared to the original scheduled retirement dates of 2042 and 2045. However, SPS sought approval in both states to retire the plant in 2032. A final decision on a retirement date is still pending in Texas, but parties to the New Mexico stipulation will not oppose SPS if, as part of its next rate case, it again seeks approval to retire the plant in 2032. The five-year difference between the requested and the agreed retirement

date accounts for the \$6 million shortfall in accelerated depreciation that is recoverable from rate-payers, another key driver of the difference between SPS' requested rate increase and the rate increase in the stipulation.

SPS seeks earlier retirement of the Tolk plant, as well as changes in its operations because of adverse water stress. Data from Four Twenty Seven, a Moody's research affiliate, ranks this location as a "red flag" zone (among the highest level of risk) for water stress. Demand for water outstrips available water supply, and is likely to be significantly worse by 2040. Data from the World Resources Institute Aqueduct Water Risk Atlas indicates a high risk of groundwater table decline in that area. SPS estimates that if it continues to operate the steam turbine generation throughout the year, instead of limiting its operation to peak summer months, the water for cooling could be fully depleted by 2024-26. The utility's initiatives to reduce its exposure to water stress and carbon transition risk are positive from an ESG perspective.

SPS anticipates that new rates in New Mexico will become effective during the second or third quarter of 2020 with hearings related to the stipulation agreement scheduled for February 2020. SPS plans to use fuel costs and tax savings to mitigate the effect of the final rate increases in New Mexico and Texas on its customer bills. The June 2019 commission of the 478 megawatt Hale wind farm drive these savings. Hale's output receives federal Production Tax Credits while it reduces the power required from thermal generation. The utility's expectation that the wind farm will report a high net capacity factor of nearly 50% drives its forecast that annual net savings could total around \$25 million.

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REPORT NUMBER 1210755



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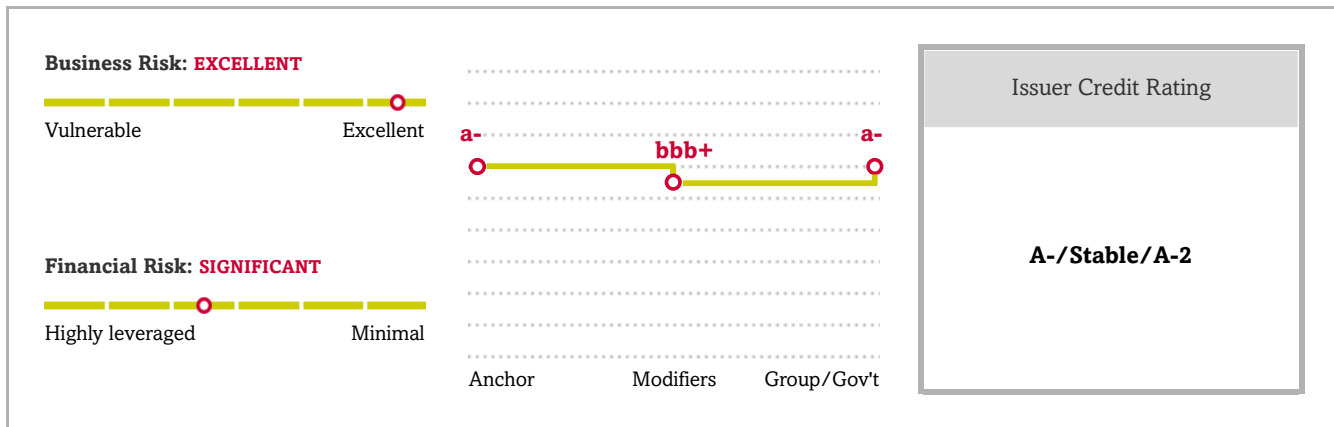
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Reconciliation

Ratings Score Snapshot

Related Criteria

# Southwestern Public Service Co.



## Credit Highlights

Overview	
Key Strengths	Key Risks
Low-risk, vertically integrated, fully rate-regulated electric utility	Relatively small customer base
Effective management of regulatory risk	Revenue concentration in Texas and New Mexico, together with environmental risks associated with coal generation (30%)
Steady utility operating cash flow	Negative discretionary cash flow, leading to external funding needs

*Southwestern Public Service Co.'s (SPS's) credit metrics are anticipated to decline*, driven primarily by higher capital spending and dividends. However, financial measures are expected to remain in the range of the financial risk profile category.

*We expect stable cash flows in the coming years*, with a consistent commercial, industrial, and residential customer base that consists of both retail and wholesale operations. However, there is geographic customer concentration, largely in Texas.

## Outlook

The stable outlook mirrors our stable outlook on parent Xcel Energy Inc. (Xcel). We base the outlook over the next 24 months on our expectation that Xcel's management will continue to reach constructive regulatory outcomes to avoid any significant rise in business risk for the regulated utilities. Specifically, our base-case forecast includes adjusted funds from operations (FFO) to debt of about 16%, and it assumes the company will continue to fund its capital investments in a balanced manner to support its capital structure.

### Downside scenario

We could lower the rating on Xcel and its subsidiaries, including SPS, if Xcel's financial ratios weaken and consistently reflect adjusted FFO to debt at or below 15%. This would most likely occur if rate-case outcomes are weaker than expected and capital spending materially rises.



## Upside scenario

We could raise the ratings if Xcel improves its collective ability to manage regulatory risk across its regulatory jurisdictions, resulting in a consistent improvement to its business risk. We could also raise the rating if the company's consolidated financial measures consistently exceed our baseline forecast, including adjusted FFO to debt of greater than 20%.

## Our Base-Case Scenario

### Assumptions

- Continued cost recovery through various regulatory mechanisms;
- Annual gross margin of about 45%;
- Annual capital spending averaging about \$785 million through 2021;
- Annual dividends averaging about \$195 million;
- Negative discretionary cash flow indicates external funding needs; and
- All debt maturities are refinanced.

### Key Metrics

	2019E	2020E	2021E
Adjusted FFO to debt (%)	13.5-15	13.5-15	13.5-15
Adjusted debt to EBITDA (x)	5-5.5	5.5-6	5.5-6
Adjusted FFO to cash interest(x)	3.8-4.3	3.8-4.3	3.9-4.5

E--Expected. FFO--Funds from operations.

## Company Description

SPS is a vertically integrated electric utility operating in Texas and New Mexico. SPS is a subsidiary of Xcel.

## Business Risk

SPS's business risk profile incorporates its relatively low-risk, rate-regulated electric utility serving about 395,000 customers. There is modest regulatory diversity because SPS operates in both Texas and New Mexico. However, Texas does account for about 70% of the utility's operating revenue. There are also wholesale sales that contribute a portion of operating revenues. Most customers (about 80%) are residential, which stabilizes operating revenue. The limited geographic and regulatory diversity and customer concentration mostly in Texas marginally weaken SPS's business risk profile. Generation sources are about 30% coal supplied, which adds some environmental risk to the company.

## Peer comparison

Table 1

Southwestern Public Service Co.--Peer Comparison				
Industry sector: Electric				
	Southwestern Public Service Co.	Southwestern Electric Power Co.	El Paso Electric Co.	Oklahoma Gas & Electric Co.
Ratings as of Nov. 14, 2019	A-/Stable/A-2	A-/Stable/--	BBB/Negative/--	A-/Stable/A-2
<b>--Fiscal year ended Dec. 31, 2018--</b>				
<b>(Mil. \$)</b>				
Revenue	1,933.2	1,821.9	903.6	2,270.3
EBITDA	553.2	529.6	319.3	836.5
Funds from operations (FFO)	447.0	378.2	236.1	670.8
Interest expense	101.6	143.9	102.2	170.2
Cash interest paid	95.6	132.6	79.7	164.7
Cash flow from operations	450.1	504.6	272.0	801.6
Capital expenditure	1,023.0	446.2	273.8	561.9
Free operating cash flow (FOCF)	(572.9)	58.4	(1.8)	239.7
Discretionary cash flow (DCF)	(703.9)	(10.9)	(59.4)	54.7
Cash and short-term investments	44.0	24.5	12.9	0.0
Debt	2,440.1	2,946.4	1,519.3	3,367.0
Equity	2,536.6	2,315.6	1,164.1	3,603.3
<b>Adjusted ratios</b>				
EBITDA margin (%)	28.6	29.1	35.3	36.8
Return on capital (%)	7.5	5.8	7.3	7.9
EBITDA interest coverage (x)	5.4	3.7	3.1	4.9
FFO cash interest coverage (x)	5.7	3.9	4.0	5.1
Debt/EBITDA (x)	4.4	5.6	4.8	4.0
FFO/debt (%)	18.3	12.8	15.5	19.9
Cash flow from operations/debt (%)	18.4	17.1	17.9	23.8
FOCF/debt (%)	(23.5)	2.0	(0.1)	7.1
DCF/debt (%)	(28.8)	(0.4)	(3.9)	1.6

## Financial Risk

Our stand-alone financial risk profile for SPS incorporates a base-case scenario that includes adjusted FFO to debt of 13.5%-15%, below the midpoint of the benchmark range of the significant category. We expect the supplemental ratio of FFO cash interest coverage to be 3.8x-4.5x, which supports the existing financial risk profile. In addition, operating cash flow after capital spending and dividends (discretionary cash flow) is expected to be negative through the forecast period ending 2021. This indicates a need for external funding such as debt issuances and cash injections from within

the Xcel group. Over the next few years, we expect debt leverage to be relatively aggressive, as indicated by debt to EBITDA averaging about 5.6x per year. Reflecting the company's steady cash flow and rate-regulated utility operations, we base our risk assessment on our medial table benchmarks. These are more relaxed benchmarks than those used for a typical corporate issuer.

## Financial summary

**Table 2**

Southwestern Public Service Co.--Financial Summary					
Industry sector: Electric					
	--Fiscal year ended Dec. 31--				
	2018	2017	2016	2015	2014
<b>(Mil. \$)</b>					
Revenue	1,933.2	1,918.0	1,851.0	1,787.2	1,937.4
EBITDA	553.2	534.9	515.1	471.9	445.2
Funds from operations (FFO)	447.0	478.1	474.8	349.9	395.1
Interest expense	101.6	104.8	108.4	102.5	96.2
Cash interest paid	95.6	98.4	102.1	98.1	92.7
Cash flow from operations	450.1	485.7	401.1	328.5	395.4
Capital expenditure	1,023.0	564.4	515.1	604.6	549.5
Free operating cash flow (FOCF)	(572.9)	(78.7)	(114.0)	(276.1)	(154.1)
Discretionary cash flow (DCF)	(703.9)	(187.5)	(199.1)	(376.6)	(237.6)
Cash and short-term investments	44.0	10.9	0.8	0.8	0.6
Gross available cash	44.0	10.9	0.8	0.8	0.6
Debt	2,440.1	2,150.3	2,035.5	1,897.3	1,694.0
Equity	2,536.6	2,130.4	1,931.7	1,807.9	1,560.5
<b>Adjusted ratios</b>					
EBITDA margin (%)	28.6	27.9	27.8	26.4	23.0
Return on capital (%)	7.5	8.0	8.9	8.8	9.7
EBITDA interest coverage (x)	5.4	5.1	4.8	4.6	4.6
FFO cash interest coverage (x)	5.7	5.9	5.7	4.6	5.3
Debt/EBITDA (x)	4.4	4.0	4.0	4.0	3.8
FFO/debt (%)	18.3	22.2	23.3	18.4	23.3
Cash flow from operations/debt (%)	18.4	22.6	19.7	17.3	23.3
FOCF/debt (%)	(23.5)	(3.7)	(5.6)	(14.6)	(9.1)
DCF/debt (%)	(28.8)	(8.7)	(9.8)	(19.9)	(14.0)

## Liquidity

We assess the company's stand-alone liquidity as adequate because we believe its liquidity sources are likely to cover uses by more than 1.1x over the next 12 months and meet cash outflows even with a 10% decline in EBITDA. The assessment also reflects our view of the company's generally prudent risk management, sound relationships with banks, and generally satisfactory standing in credit markets.

### **Principal Liquidity Sources**

- Credit facility availability of about \$400 million;
- Estimated cash FFO of \$450 million;
- Cash and liquid investments of about \$500,000; and
- Parental equity infusion of about \$270 million.

### **Principal Liquidity Uses**

- Debt maturities, including outstanding commercial paper, of about \$175 million;
- Capital spending of about \$625 million; and
- Dividends of about \$175 million.

## **Other Credit Considerations**

The stand-alone credit profile incorporates a one-notch negative adjustment, based on our expectation that the financial measures in our base-case scenario are trending toward the lower end of the range for its financial risk profile category.

## **Environmental, Social, And Governance**

Governance and social factors for the company, in relation to our ESG assessment, are consistent with what we see across the industry for other publicly traded utilities. Parent Xcel's reliance on coal-fired generation exposes it to the ongoing cost of operating older units in the face of disruptive technological advances and the potential for more environmental regulations requiring significant capital investments. However, the company is trying to reduce its carbon footprint; its near-term plan is to retire 1,400 megawatts (MW) of coal-fueled generation in the upper Midwest of the U.S. This will be replaced with a \$3 billion investment in a combined-cycle natural gas plant and 1,850 MW of wind generation. Also, in Colorado the company plans to retire additional coal-based generation and invest in wind, solar, and existing natural gas resources as well as add 275 MW of large-scale battery storage. By pursuing greater renewable generation, the company is meeting customer demand for greener energy. In addition, Xcel operates two nuclear plants (expected to remain open through 2034) that generate about 1,700 MW of power. Although carbon-free, the company's nuclear generation portfolio increases operating risk and exposes it to longer-term nuclear waste storage risks.

## **Group Influence**

Under our group rating methodology, we consider SPS to be a core subsidiary of parent Xcel. This reflects our view that SPS is highly unlikely to be sold, is integral to the overall group strategy, possesses a strong long-term commitment from senior management, and is closely linked to the parent's name and reputation. We align our issuer credit rating on SPS with Xcel's 'a-' group credit profile.

## Issue Ratings

We base the short-term rating on SPS on the issuer credit rating on the company.

## Issue Ratings - Subordination Risk Analysis

### Capital structure

SPS's capital structure consists of about \$1.5 billion of first-mortgage bonds and \$300 million of senior unsecured notes.

### Analytical conclusions

We rate SPS's senior unsecured debt the same as the issuer credit rating because it is the debt of a qualifying investment-grade utility.

## Issue Ratings - Recovery Analysis

SPS's first-mortgage bonds benefit from a first-priority lien on substantially all of the utility's real property owned or subsequently acquired. Collateral coverage of more than 1.5x supports a recovery rating of '1+' and an issue rating one notch above the issuer credit rating.

## Reconciliation

**Table 3**

### Reconciliation Of Southwestern Public Service Co.'s Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. \$)

--Fiscal year ended Dec. 31, 2018--

#### Southwestern Public Service Co.'s reported amounts

	Debt	EBITDA	Operating income	Interest expense	S&P Global Ratings' adjusted EBITDA	Cash flow from operations	Capital expenditure
	2,168.1	521.3	311.7	75.6	553.2	446.3	1,020.9
<b>S&amp;P Global Ratings' adjustments</b>							
Cash taxes paid	--	--	--	--	(10.6)	--	--
Cash taxes paid: Other	--	--	--	--	--	--	--
Cash interest paid	--	--	--	--	(71.2)	--	--
Operating leases	48.4	5.1	3.4	3.4	(3.4)	1.7	--
Postretirement benefit obligations/ deferred compensation	69.0	--	--	--	--	--	--
Accessible cash and liquid investments	(44.0)	--	--	--	--	--	--
Capitalized interest	--	--	--	8.9	(8.9)	(8.9)	(8.9)

**Table 3**

Reconciliation Of Southwestern Public Service Co.'s Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. \$) (cont.)							
Power purchase agreements	173.0	23.1	12.1	12.1	(12.1)	11.0	11.0
Asset retirement obligations	25.6	1.6	1.6	1.6	--	--	--
Nonoperating income (expense)	--	--	19.5	--	--	--	--
EBITDA: Other income/(expense)	--	2.1	2.1	--	--	--	--
Depreciation and amortization: Other	--	--	(2.1)	--	--	--	--
Total adjustments	272.0	31.9	36.6	26.0	(106.2)	3.8	2.1
<b>S&amp;P Global Ratings' adjusted amounts</b>							
	<b>Debt</b>	<b>EBITDA</b>	<b>EBIT</b>	<b>Interest expense</b>	<b>Funds from operations</b>	<b>Cash flow from operations</b>	<b>Capital expenditure</b>
	2,440.1	553.2	348.3	101.6	447.0	450.1	1,023.0

## Ratings Score Snapshot

### Issuer Credit Rating

A-/Stable/A-2

### Business risk: Excellent

- **Country risk:** Very low
- **Industry risk:** Very low
- **Competitive position:** Strong

### Financial risk: Significant

- **Cash flow/leverage:** Significant

### Anchor: a-

### Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Strong (no impact)
- **Comparable rating analysis:** Negative (-1 notch)

### Stand-alone credit profile : bbb+

- **Group credit profile:** a-

- **Entity status within group:** Core (+1 notch from SACP)

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - Utilities: Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix						
Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of December 2, 2019)*	
<b>Southwestern Public Service Co.</b>	
Issuer Credit Rating	A-/Stable/A-2
Commercial Paper	
<i>Local Currency</i>	A-2
Senior Secured	A
Senior Unsecured	A-
<b>Issuer Credit Ratings History</b>	
23-Jun-2010 <i>Foreign Currency</i>	A-/Stable/A-2
10-Jun-2009	BBB+/Positive/A-2
16-Oct-2007	BBB+/Stable/A-2

**Ratings Detail (As Of December 2, 2019)\*(cont.)**

23-Jun-2010	<i>Local Currency</i>	A-/Stable/A-2
10-Jun-2009		BBB+/Positive/A-2
16-Oct-2007		BBB+/Stable/A-2

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.



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DECEMBER 2, 2019 12

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**Summary:**

**Southwestern Public Service Co.**

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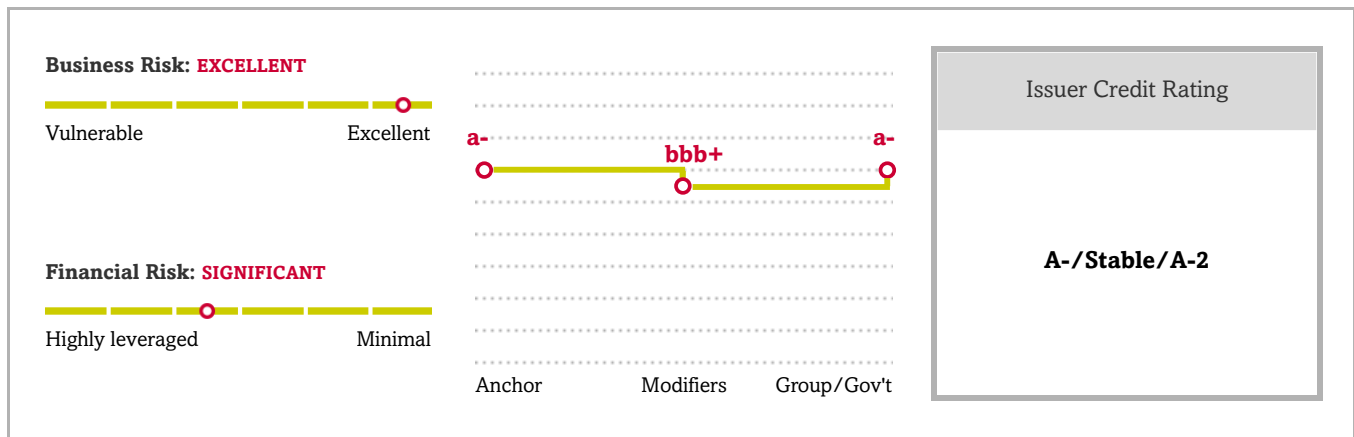
Issue Ratings--Subordination Risk Analysis

Issue Ratings--Recovery Analysis

Related Criteria

**Summary:**

**Southwestern Public Service Co.**



**Rationale**

Business Risk: Excellent	Financial Risk: Significant
<ul style="list-style-type: none"> <li>• Low-risk, vertically integrated, fully rate-regulated electric utility;</li> <li>• Effective management of regulatory risk;</li> <li>• Relatively small, mostly residential customer base; and</li> <li>• Revenue concentration in Texas together with environmental risks associated with coal generation.</li> </ul>	<ul style="list-style-type: none"> <li>• Steady, regulated utility operating cash flow;</li> <li>• Financial measures consistent with the lower end of the range for its financial risk profile category;</li> <li>• Elevated capital spending; and</li> <li>• Negative discretionary cash flow, leading to external funding needs.</li> </ul>

## Outlook: Stable

The stable rating outlook on Southwestern Public Service Co. (SPS) reflects that of parent Xcel Energy Inc. Over the next two years, S&P Global Ratings' expects Xcel Energy's management to continue to reach constructive regulatory outcomes to avoid any significant rise in business risk for the regulated utilities. Specifically, our base case forecast includes adjusted funds from operations (FFO) to debt of about 16% and assumes the company will continue to fund its capital investments in a balanced manner to support its capital structure.

### Downside scenario

We could lower the rating on Xcel Energy and its subsidiaries, including SPS, over the next 12 months if Xcel Energy's financial ratios weaken and consistently reflect adjusted FFO to debt at or below 15%. This would most likely occur if rate-case outcomes are weaker than expected and capital spending materially rises.

### Upside scenario

We could raise the ratings over the next 12 months if Xcel Energy improves its collective ability to manage regulatory risk across its regulatory jurisdictions, resulting in a consistent improvement to its business risk. We could also raise the rating if the company's consolidated financial measures consistently exceed our baseline forecast, including adjusted FFO to debt of greater than 20%.

## Our Base-Case Scenario

Assumptions	Key Metrics			
<ul style="list-style-type: none"> <li>• Continued use of regulatory mechanisms</li> <li>• Annual gross margin of about 45%</li> <li>• Annual capital spending of about \$1 billion through 2019</li> <li>• Annual dividend payments averaging about \$115 million</li> <li>• Negative discretionary cash flow every year, indicating external funding needs</li> <li>• All debt maturities refinanced</li> </ul>	<b>2017A</b>	<b>2018E</b>	<b>2019E</b>	
	Adjusted FFO to debt (%)	22.1	15-17	13-15
	Adjusted debt to EBITDA (x)	4.1	4.5-5.5	5.5-6.5
	Adjusted FFO cash interest coverage (x)	7.3	4.7-6	4-5
A—Annual. E—Estimate. FFO—Funds from operations.				

## Company Description

SPS, a wholly owned subsidiary of Xcel Energy, operates as an electricity utility in Texas and New Mexico.

## Business Risk: Excellent

SPS's stand-alone business risk profile incorporates its relatively low-risk rate-regulated electric utility serving about 390,000 mostly residential customers (about 80%) provide a level of revenue stability. The limited geographic and regulatory diversity and customer concentration mostly in Texas, marginally weaken SPS's business risk profile. Generation sources that about 40% coal-supplied, adds some environmental risk to the company.

## Financial Risk: Significant

Our stand-alone financial risk profile for SPS incorporates a base-case scenario that includes adjusted FFO to debt averaging about 16%, below the midpoint of the benchmark range of the significant category. We expect the supplemental ratio of FFO cash interest coverage to be in the 5x-5.5x range, supporting the existing financial risk profile. In addition, operating cash flow after capital spending and dividends, or discretionary cash flow, to be mostly negative over the next several years. This indicates a need for external funding such as debt issuances and cash injections from within the Xcel Energy group. Over the next few years, we expect debt leverage to be relatively aggressive as indicated by debt to EBITDA averaging about 5.25x. Reflecting the company's steady cash flow and rate-regulated utility operations, we base our risk assessment on our medial table benchmarks. These are more relaxed benchmarks as compared to those used for a typical corporate issuer.

## Liquidity: Adequate

We assess the company's stand-alone liquidity as adequate because we believe its liquidity sources are likely to cover uses by more than 1.1x over the next 12 months and meet cash outflows even with a 10% decline in EBITDA. The assessment also reflects our view of the company's generally prudent risk management, sound relationship with banks, and a generally satisfactory standing in credit markets.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> <li>Estimated cash FFO of about \$420 million;</li> <li>Credit facility availability of \$400 million; and</li> <li>About \$4 million cash and liquid investments.</li> </ul>	<ul style="list-style-type: none"> <li>Debt maturities of about \$10 million;</li> <li>Capital spending of about \$510 million;</li> <li>Dividend payments of about \$125 million; and</li> <li>Working capital outflows of about \$90 million.</li> </ul>

## Other Credit Considerations

The stand-alone credit profile on SPS incorporates a one-notch negative adjustment based on our expectation that the financial measures in our base-case scenario are trending toward the lower end of the range for its financial risk profile category.

## Group Influence

Under our group rating methodology, we consider SPS as a core subsidiary of its parent Xcel Energy, reflecting our view that it is highly unlikely to be sold, is integral to the overall group strategy, possesses a strong long-term commitment from senior management, and is closely linked to the parent's name and reputation. We therefore assess SPS's issuer credit rating to be in line with Xcel Energy's group credit profile of 'a-'.

## Ratings Score Snapshot

### Issuer Credit Rating

A-/Stable/A-2

### Business risk: Excellent

- **Country risk:** Very low
- **Industry risk:** Very low
- **Competitive position:** Strong

### Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: a-

### Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Strong (no impact)
- **Comparable rating analysis:** Negative (-1 notch)

Stand-alone credit profile : bbb+

- **Group credit profile:** a-
- **Entity status within group:** Core (+1 notch from SACP)

## Issue Ratings

We base the short-term rating on SPS on the issuer credit rating on the company.

## Issue Ratings--Subordination Risk Analysis

### Capital structure

SPS's capital structure consists of about \$1.5 billion of first-mortgage bonds and \$300 million of senior unsecured notes.

### Analytical conclusions

We rate SPS's senior unsecured debt the same as the issuer credit rating because it is the debt of a qualified investment-grade utility.

## Issue Ratings--Recovery Analysis

SPS's first-mortgage bonds benefit from a first-priority lien on substantially all of the utility's real property owned or subsequently acquired. Collateral coverage of more than 1.5x supports a recovery rating of '1+' and an issue rating one notch above the issuer credit rating.

## Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - Utilities: Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Summary: Southwestern Public Service Co.

<b>Business And Financial Risk Matrix</b>						
<b>Business Risk Profile</b>	<b>Financial Risk Profile</b>					
	Minimal	Modest	Intermediate	<b>Significant</b>	Aggressive	Highly leveraged
<b>Excellent</b>	aaa/aa+	aa	a+/a	<b>a-</b>	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-



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