

DW 23-040
PENNICHUCK WATER WORKS, INC.
Request For Approval Of Financing
DOE Data Requests - Set 1

Date Request Received: 4/18/23
Request No. Department 1-1

Date of Response: 4/24/2023
Witness: George Torres

REQUEST:

Ref: Petition, Bates page 5, paragraph 9

Please provide an update regarding the requested approval from the Board of Alderman for the City of Nashua.

RESPONSE:

An approval from the City of Nashua's Board of Alderman was obtained on April 3, 2023 and the resolution was filed as a supplement to the petition in Docket No. DW 23-040 on April 19, 2023.

DW 23-040
PENNICHUCK WATER WORKS, INC.
Request For Approval Of Financing
DOE Data Requests - Set 1

Date Request Received: 4/18/23
Request No. Department 1-2

Date of Response: 4/24/2023
Witness: George Torres

REQUEST:

Ref: Petition, Bates page 2, paragraph 2

The Petition states, "The proposed two (3) year renewal..." Please confirm whether the term of the requested FALOC is 2 years or 3 years

RESPONSE:

As described on page 1 of Exhibit GT-5 - TD Bank FALOC Term Sheet submitted with the petition (Bates 028), the proposed term on the renewed FALOC is for a two-year period beginning on July 1, 2023 and expiring on June 30, 2025.

DW 23-040
PENNICHUCK WATER WORKS, INC.
Request For Approval Of Financing
DOE Data Requests - Set 1

Date Request Received: 4/18/23
Request No. Department 1-3

Date of Response: 4/24/2023
Witness: George Torres

REQUEST:

Ref: Petition, Bates page 2, paragraph 3

Please briefly explain the Company's efforts to secure a term longer than 2 years.

RESPONSE:

What the company has been told verbally in previous meetings with the credit team of TD Bank, is that based on the Company's size, credit profile and current credit environment, the bank is only able to provide a two-year facility on the PWW FALOC.

In fact, when the FALOC was initially presented by TD Bank, the credit team was only willing to provide a one-year term, which the Company then successfully negotiated for the now current two-year facility.

DW 23-040
PENNICHUCK WATER WORKS, INC.
Request For Approval Of Financing
DOE Data Requests - Set 1

Date Request Received: 4/18/23
Request No. Department 1-4

Date of Response: 4/24/2023
Witness: George Torres

REQUEST:

Is the Company required to maintain a certain credit rating as part of the process of obtaining the FALOC from TD Bank, N.A.? If in the affirmative, please provide the most recent rating applied to the Company, and when that rating was determined.

RESPONSE:

As described on page 2 of Exhibit GT-5 - TD Bank FALOC Term Sheet submitted with the petition (Bates 028), Pennichuck Water Works needs to maintain a S&P bond rating of at least BBB+.

On March 16, 2023, S&P Global Ratings issued its most recent credit rating of the Company and has affirmed on the Company's rating of "A" with a stable outlook. This most recent credit rating issuance was done in association with Pennichuck Water Works 2023 annual bond offering which was priced and sold on April 12, 2023, and is closing on April 26, 2023. This affirmed rating exceeds the minimum requirement in Exhibit GT-5. A copy of that S&P Global Ratings Report for the Company is attached as Exhibit DOE 1-4 to this data request.

RatingsDirect®

Summary:

Pennichuck Water Works Inc., New Hampshire New Hampshire Business Finance Authority; Water/Sewer

Primary Credit Analyst:

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Table Of Contents

Credit Highlights

Outlook

Credit Opinion

Related Research

Summary:

Pennichuck Water Works Inc., New Hampshire New Hampshire Business Finance Authority; Water/Sewer

Credit Profile

US\$5.695 mil wtr facs rev bnds (Pennichuck Wtr Works, Inc) ser 2023A due 04/01/2058

<i>Long Term Rating</i>	A/Stable	New
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US\$0.09 mil wtr facs rev bnds (federally taxable) (Pennichuck Wtr Works, Inc) ser 2023B due 04/01/2025

<i>Long Term Rating</i>	A/Stable	New
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New Hampshire Bus Fin Auth, New Hampshire

Pennichuck Wtr Works, Inc, New Hampshire

New Hampshire Bus Fin Auth (Pennichuck Wtr Works, Inc) WTRSWR

<i>Long Term Rating</i>	A/Stable	Affirmed
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New Hampshire Bus Fin Auth (Pennichuck Wtr Works, Inc) WTRSWR

<i>Long Term Rating</i>	A/Stable	Affirmed
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Credit Highlights

- S&P Global Ratings affirmed its 'A' long-term rating on the New Hampshire Business Finance Authority's debt issued on behalf of Pennichuck Water Works Inc. (PWW).
- At the same time, S&P Global Ratings assigned its 'A' long-term rating to the authority's approximately \$5.7 million series 2023A tax-exempt and \$90,000 series 2023B taxable water facility revenue bonds issued for PWW. Despite the two-year maturity of the series 2023B bonds, we are assigning a long-term rating to that series as well, as the bonds are pledged to net revenues of PWW, rather than being retired using payments of a future debt issuance.
- The outlook is stable.

Security

Bonds are repaid from net revenues of the water system. Bond proceeds from this sale will be used as a deposit into PWW's project fund for capital improvements and to pay issuance costs. Including this issuance, PWW will have about \$135 million in revenue bonds outstanding, including state revolving fund loans (SRFLs). We believe bond provisions are standard. These include a 1.1x rate covenant and a 1.1x additional bonds test against maximum annual debt service (MADS) on parity debt.

Credit overview

The utility is a drinking-water treatment and distribution system purchased in 2012 by the City of Nashua (AAA/Stable), which remains the sole shareholder in a unique operating structure among the water utilities that we rate. Although headquartered in Nashua, PWW also serves smaller populations in several surrounding communities. PWW must undergo an extensive and time-consuming rate case with the New Hampshire Public Utilities Commission

(PUC) any time it seeks to increase rates. Still, the regulatory relationship has been--and we expect will remain--supportive of continued operational improvements. In New Hampshire, a utility's revenue-raising ability in a rate case is based on an approved revenue requirement, and, in conformity with regulatory requirements, PWW applies for rate adjustments every three years. This cycle has, in the past, caused cash levels in the final year to be below those of many similarly rated peers. The rate approval at the end of 2020 that increased rates by 11.85%, however, continues a supportive trend from the regulator to allow PWW to include a material operating expense factor (MOEF) in the approved rate. We believe that the MOEF, which sets a 9.5% escalation factor to PWW's material operating expense revenue requirement (MOERR), fixing a revenue level at 1.095x of each test year's allowed revenues to aid in covering recoverable operating expense growth, should help add stability to the utility's revenue stream between rate cases. While we believe that extended rate-case processes for all rated regulated utilities limit the ability to quickly respond to weaker financial results, the New Hampshire PUC approval process does allow for emergency rate cases to be adjudicated. Our calculation of debt service coverage is low for the rating level due to various debt service payments and transfers to Nashua and Pennichuck Corporation (the parent), as well as the restrictions in raising rates.

PWW has drawn on various reserves, as designed to occur, to bridge the period between rate cases and maintain operations and capital. This practice lowers comparable cash metrics. Historical issues funded PWW's MOERR rate stabilization fund (RSF) and repaid a tapped line of credit. While we generally view the funding of the RSF and payment extension as a credit negative, we understand that these are structural elements of the utility's regulated environment. This reserve replenishment and the MOEF, we believe, help provide a more stable cash position.

The enterprise risk profile reflects the following:

- The local economy being a diverse mix of commercial and retail businesses within the Manchester-Nashua metropolitan area and just 34 miles north of Boston. Nashua's median household effective buying income (MHHEBI) is 113% of the national average.
- The monthly customer bill for 7.48 hundred cubic feet (ccf) of water service is about \$56.14, equal to 1.1% of MHHEBI, with a Hillsborough County poverty rate of 7.1%. We view these metrics as affordable, given healthy area incomes. Monthly water rates are currently based on a fixed system charge and volumetric water rates.
- Based on our Operational Management Assessment, we view the system's operational management as good. The Merrimack River and Pennichuck Brook supply the core system, supplemented with reservoir storage, and there is a single water treatment plant. Individual wells and purchased water from interconnections with local municipalities supply the community systems. The system has a capacity of 31.2 million gallons per day (mgd), which compares favorably with a relatively stable average daily demand of about 13.3 mgd. According to management, there have been significant efforts to develop succession planning and workforce training in recent years, particularly given the exceptionally low unemployment in the Nashua area in recent years.

The financial risk profile reflects the following:

- Combining available liquidity sources, cash on hand is adequate, in our view, at \$9.1 million at fiscal year-end 2022, equal to 179 days' cash, up from a weak \$1.2 million in 2019, or just 21 days' cash, thanks to reserve replenishment included in a bond sale. Additional liquidity is available through a \$12 million line of credit with TD Bank and a \$4 million line of credit with Pennichuck Corp. We note that this operating cash level is low for the current 'A' rating

level.

- Net operating revenue, or EBITDA, typically covers PWW's fixed costs at or around a ratio of about 1x. We include in our calculations revenue bond debt service, SRFL payments, and the subordinate city bond fixed revenue requirement (CBFRR), which is used to repay the city's general obligation (GO) debt used in 2012 to purchase the utility.
- We view the system's Financial Management Assessment as good, meaning policies are embedded and likely sustainable. Long-term financial planning is detailed and reasonable, although limited by the uncertainty of PUC approval. The system's capital plan focuses on upgrading the water supply, replacement and rehabilitation projects, and other minor projects. The three-year capital program through fiscal 2025 is about \$46.8 million. A line of credit, replenished with occasional long-term bonds, will finance the projects. In our view, the system's debt-to-capitalization ratio was moderately high, at 59.5%.

Environmental, social, and governance

We analyzed the utility's environmental, social, and governance (ESG) opportunities and risks relative to its economic fundamentals, market position, operational management, coverage, and liquidity.

We believe the authority's environmental risk is credit neutral. PWW has noted that they are currently in compliance with environmental regulation regarding per- and polyfluoroalkyl substances (PFAS) with the New Hampshire Department of Environmental Services (NHDES). Currently, PWW is using a treatment filtration system to address PFAS contamination in water reserves. We note that PFAS contamination may become a larger financial concern, pending any potential further regulations on the state or federal level. The service area of PWW is also vulnerable to chronic and acute physical climate risks, given its exposure to drought in recent years, although the utility system notes it has ample water supply from the Merrimack River, as well as an asset management plan.

We view social risks as credit neutral, due to healthy service area economics. If project cost overruns result in additional debt needs and rate increases, the authority's social risks could become further elevated. We believe rate increases may assist PWW in maintaining compliance with its financial covenants, with Nashua's MHHEBI of about 113% being supportive of further rate increases. PWW's current capital plan shows about \$46.8 million of projects through 2025, with all system upgrades pertaining to corrective maintenance, along with renewals and replacements of the system. In our opinion, PWW's current facilities are adequately sized to meet both present and future needs.

In our opinion, PWW's governance risk is moderately negative and higher than that of unregulated peers, as rate regulation by the PUC limits the utility's ability to adjust revenues in a timely manner as needed. The PUC also restricts the amount of cash that PWW can hold in available reserves. The additional complexity of managing the relationship with Pennichuck Corp., the parent company, also elevates the governance risk above the sector standard. We positively view how PWW works to actively mitigate cyber risks and maintains cyber security standards by assessing internal vulnerabilities and training employees.

Outlook

The stable outlook reflects our view that the authority will continue to set rates to generate sufficient revenues for all its costs without reliance on the RSF to support ongoing capital expenditure costs. We base this view on our

assessment that the New Hampshire PUC will continue to approve supportive ongoing rate increases to address capital needs. Given the corporation's regulatory status, we expect regular fluctuations in financial performance in between rate cases. However, the stable outlook reflects the ability of the corporation to recover its costs for capital and operating expenses in a way that minimizes reliance on RSF usage, while maintaining a minimum of at least \$5 million in the RSF.

Downside scenario

We could take a negative rating action if PWW's cash position returns to a weak comparable level and future PUC approvals of rate increases stall, or if liquidity is spent down unexpectedly. In addition, although unlikely, we could lower the rating if the service area economy materially deteriorates or the customer base declines over time.

Upside scenario

We could take a positive rating action if liquidity rises to what we consider a very strong level and is commensurate with a higher rating, and if debt and coverage metrics moderate to be more in line with those of higher-rated peers. However, we believe financial metrics will not significantly improve within the outlook due to regulation by the New Hampshire PUC preventing significant rate increases to improve coverage and liquidity.

Credit Opinion

The service area centers on Nashua, the second-largest city in New Hampshire, as Nashua owns Pennichuck Corp., PWW's parent. The system includes the core water system and four wholesale community water systems. We believe its customer base is diverse, with the top 10 retail customers accounting for around 7.0% of 2022 revenues. The largest retail customer is Anheuser-Busch Inc., at about 2.1% of total revenues; no other customer in the top 10 contributes more than 1.0%. Anheuser-Busch must make a minimum monthly payment under its water supply contract with the utility.

The utility operates in a more corporate parent-child relationship than other municipally owned systems in the region. Therefore, management operates to close each fiscal year with an audited cash position of just \$6,000. As additional debt is issued for ongoing capital projects, the related debt service costs would still be recoverable through PWW's debt service revenue requirement, including a 10-basis-point allowable multiple. However, there could be downside risk to the rating if PWW starts to structure future bonds with debt service that causes total fixed costs (when considering all of the sources of fixed costs as identified above) to be both higher and escalating over time. We consider this a credit negative because it would again start to lower the predictability of PWW's financial profile, since future PUC rate approvals would need to take into account both higher and escalating debt service costs; it is our understanding that PWW is attempting to avoid this issue with level debt service structures on additional debt.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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DW 23-040
PENNICHUCK WATER WORKS, INC.
Request For Approval Of Financing
DOE Data Requests - Set 1

Date Request Received: 4/18/23
 Request No. Department 1-5

Date of Response: 4/24/2023
 Witness: George Torres

REQUEST:

Ref: Attachments of Mr. Torres, Bates page 21, and Bates page 17, lines 9-13
 Please explain further, with amounts, how the Company arrived at the listed adjustment of \$16,200

RESPONSE:

The Debt Issuance expenses of \$16,200 is attributed to the renewal of the PWW FALOC as follows:

TD Bank FALOC Renewal Fee:	\$12,000.00
Estimate of Legal Fees for renewal:	<u>15,000.00</u>
Total Fees associated with renewal:	\$27,000.00
Less: Amortization of Issuance Costs	
(\$27,000 Cost / 2.5 yr. Amortization Period)	<u>(10,800.00)</u>
Remaining Debt Issuance Cost Balance after Yr. 1	<u>\$16,200.00</u>

Based upon further review of the calculations, the proper amortization period to be used for the FALOC renewal should be 2 years and not 2.5 years, therefore reducing the remaining Debt Issuance Cost balance after year 1 to \$13,500.

$$(\$27,000 \text{ Cost} / 2 \text{ yr. Amortization Period}) = 13,500.00 \text{ per year}$$

Therefore:

Total Fees associated with renewal:	\$27,000.00
Less: Amortization of Issuance Costs	
(\$27,000 Cost / 2 yr. Amortization Period)	<u>(13,500.00)</u>
Remaining Debt Issuance Cost Balance after Yr. 1	<u>\$13,500.00</u>

The Company re-asserts that the costs associated with this renewal are estimates at this time, so the final amounts for issuance costs may change upon completion of the FALOC renewal. However, PWV believes the amounts presented are fair representations of the final costs, and any variations in these costs are expected to be immaterial.

DW 23-040
PENNICHUCK WATER WORKS, INC.
Request For Approval Of Financing
DOE Data Requests - Set 1

Date Request Received: 4/18/23
Request No. Department 1-6

Date of Response: 4/24/2023
Witness: George Torres

REQUEST:

Ref: Testimony of Mr. Torres, bates page 15, line 3

Regarding capital expenditures charged to the FALOC, please briefly explain:

a) How the Company ensures all capital expenditures placed on the FALOC before the annual bonding are associated with projects completed as of December 31 of the prior year; and

b) How the Company ensures all capital expenditures incurred associated with projects started after January 1 of the current year are not charged to the FALOC until after the annual bonding. If there is a moratorium on projects, please include that as well.

RESPONSE:

- a) All projects projected to be used-and-useful within the current calendar year are included in any FALOC draws that occur throughout the year. An internal final review of all projects included in any FALOC draw is then performed and completed by February 15th of the following year, as part of the Company's QCPAC filing. This ensures only prior year used-and-useful, QCPAC eligible, and bondable projects are included in the final amount.

In the event a project has not gone used-and-useful in the prior year and FALOC monies were drawn against for that project, then the FALOC is either reimbursed with available DSRR 0.1 funds or rolled into the following year's FALOC draws, prior to finalization of the QCPAC filing.

- b) In the rare event that a project is undertaken, or a capital expenditure is made, in the subsequent year but prior to the annual bonding event in April, the Company will finance it with available PWW DSRR 0.1 funds until the FALOC is ultimately cleaned-out with

the annual bond proceeds. It is only then when the FALOC is made available once more to fund that year's capital expenditures.

The Company imposes an internal moratorium on the usage of the FALOC in the months leading up to the annual bond issuance and FALOC cleanout in April of each year. Draws on the FALOC occur throughout any year after the FALOC is reopened at the end of April. Draws occur until the last one or two is done in early January for bills presented by vendors for work done and billed for December of the prior year, but no later than the second week of January. Those amounts can be paid with final FALOC draws for the just completed year, along with final work order activity for capital projects, identified, reconciled and verified as a part of the year-end closing process. During this moratorium period, capital project needs are temporarily shut off, with the exclusion of certain emergency capital projects, for which DSRR 0.1 funds collected and available from the prior year are used to fund those amounts. Those funds are then refunded with a FALOC draw after the facility is reopened in May, as described in the response above.

DW 23-040
PENNICHUCK WATER WORKS, INC.
Request For Approval Of Financing
DOE Data Requests - Set 1

Date Request Received: 4/18/23
 Request No. Department 1-7

Date of Response: 4/24/2023
 Witness: George Torres

REQUEST:

Ref: Petition, Bates page 7, paragraph 12

Please indicate the projected impact of the Renewed FALOC on the subsequent customer rates and, also, provide a supporting schedule which shows the calculation of that projected impact.

RESPONSE:

The FALOC itself does not have an impact on customer rates, other than the capitalized interest accrued during the year as money is drawn down and included in the QCPAC, and included in the annual bonding event to pay-off the FALOC to zero each year by April 30, replacing it with long term bonds. The actual cost of this FALOC interest is variable, as it depends upon the amounts drawn within the year and the time in the year for which they are drawn (interest is calculated monthly based upon the average balance outstanding on the line for that month). Additionally, as the Company is awaiting the final rate order under DW 22-032, the actual impact on customer rates cannot be finally determined, as the impact of this forward-looking calculation will be applied to those new permanent rates, once ordered and approved by the Commission. As an overall macro calculation, if a renewed FALOC at \$12 million was fully drawn down to a level of \$11.5 million, ratably during the year (allowing for capacity under the FALOC cap for capitalized interest), at an interest rate of approximately 6%, the capitalized cost of interest each year would be:

$$\$11,500,000 \times .06 \times 50\% = \$345,000 \text{ of capitalized interest}$$

This \$345,000 each year as included in the annual bond issuance, for 30 years at 5%, would result in a debt service includable in rates under the DSRR 1.1 component of rates of approximately \$24,687 per annum:

Calculated using Excel in the following formula and components:

$$=PMT ((.05 / 12,30*345,000)*12)*1.1 = \$24,687 \text{ per annum}$$

As such, the impact of the annual inclusion of \$24,687 (DSRR 1.0 and DSRR 0.1) on the average customer monthly bill, in this most all-encompassing usage of the line, as an example of the maximum impact on rates, once included in the QCPAC, using the most recent allowed revenue requirement for PWV from DW 19-084 is \$0.039.

Calculated Maximum Impact against Allowed Revenues from DW 19-084

$$= (\$24,687/\$35,819,773) = 0.07\%$$

Monthly Impact on Single Family Residential Bill = $(0.07\% \times \$55.68) = \0.039

As demonstrated above, in the event the Company fully utilized the FALOC, the potential rate impact on the single-family residential bill would be approximately \$0.039 per month.