BEFORE THE

WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

UG-__

GENERAL RATE APPLICATION

OF

NORTHWEST NATURAL GAS COMPANY

December 18, 2020

Direct Exhibit of Brody J. Wilson

COST OF CAPITAL

Exh. BJW-2

MOODY'S
INVESTORS SERVICE

CREDIT OPINION
29 May 2020

Update

Rate this Research

RATINGS

Northwest Natural Gas Company	
Domicile	Portland, Oregon, United States
Long Term Rating	(P)Baa1
Type	Senior Unsec. Shelf - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Northwest Natural Gas Company

Update to credit analysis

Summary

Northwest Natural Gas Company's (NW Natural, Baa1 stable) credit profile is supported by its low business risk as a local gas distribution company (LDC) and a supportive regulatory environment with a suite of cost recovery mechanisms and constructive stakeholder relationships.

NW Natural's credit profile is constrained by weak financial metrics compared to most LDCs, including a ratio of cash flow from operations before changes in working capital to debt (CFO pre-WC to debt) expected to be around 16%, before including any effects of the COVID-19 virus. The financial profile is further limited by a shareholder dividend policy that has driven a payout ratio average of around 80% for the past five years, resulting in adjusted CFO pre-WC less dividends to debt of around 13% over that time (7.8% through the last twelve months (LTM) ended 31 March 2020). While this also weakens its peer positioning, we note that the company pays dividends in accordance with maintaining its regulatory capital structure.

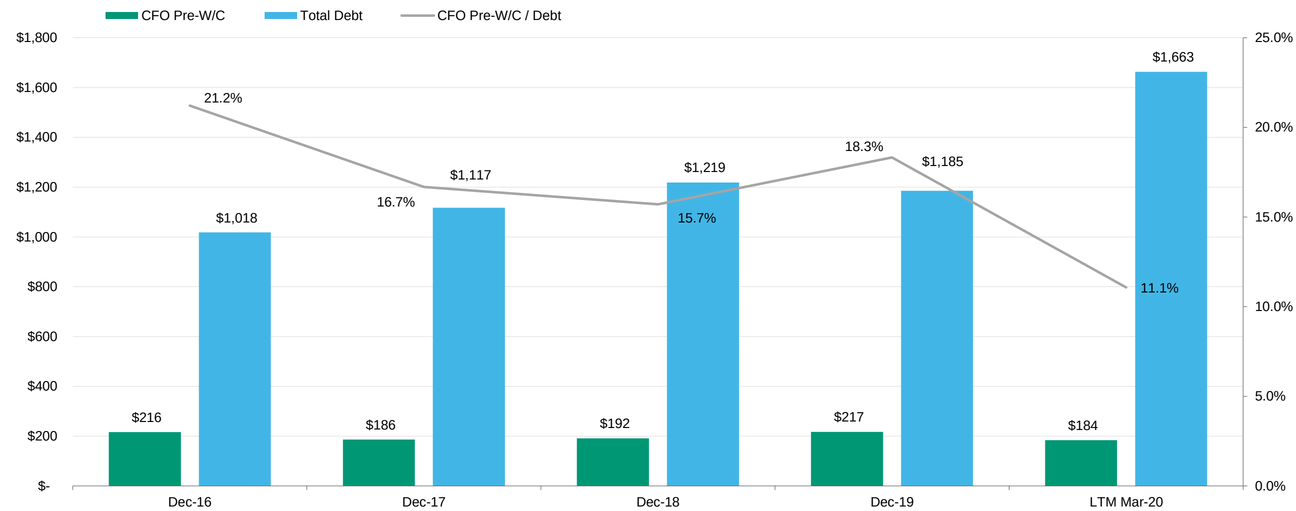
COVID-19 developments

The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

We expect NW Natural to be resilient to recessionary pressures related to the coronavirus because of its rate-regulated, essential service business model. Nevertheless, we are watching for gas usage declines, utility bill payment delinquency, and the regulatory response to counter these effects on earnings and cash flow. As the events related to the coronavirus unfold, we are taking into consideration a wider range of potential outcomes, including more severe downside scenarios.

The effects of the pandemic could result in financial metrics that are weaker than expected; however, we see these issues as temporary and not reflective of the core operations or longterm financial or credit profile of NW Natural.

Exhibit 1
Historical CFO Pre-WC, Total Debt and CFO Pre-WC to Debt ($ MM)



LTM ratio has declined due to temporary debt incurred in 1Q20 with a commensurate amount of cash on the balance sheet
Source: Moody's Financial Metrics

Credit strengths

» Low business risk local gas distribution company

» Supportive regulatory jurisdiction, including cost tracking mechanisms and recent legislation that can help investment prospects

» Good stakeholder relationships and ongoing dialogue to resolve most issues

Credit challenges

» Financial metrics historically trail those of peers

» Dividend payout ratio typically around 80% of earnings, but likely to decline and remain at a level necessary to keep the 48% equity capitalization allowed by the OPUC

» Long-term risks associated with environmental remediation costs and emissions reductions in the region

Rating outlook

NW Natural's stable outlook reflects constructive regulatory decisions that will help maintain the company's financial profile, including CFO pre-WC to debt up to 17% on a sustained basis. We also view the company as having low stranded asset risk given the state's policy goals of advancing renewable natural gas as a form of decarbonization.

Factors that could lead to an upgrade

» Sustainable CFO pre-WC to debt around 18%

» CFO pre-WC less dividends to debt consistently above 14%

» Enhanced cost recovery features

Factors that could lead to a downgrade

» Less supportive regulatory outcomes with the OPUC

» CFO pre-WC to debt sustained below 14%

» Material environmental challenges where costs cannot be recovered

Key indicators

Exhibit 2
Northwest Natural Gas Company [1]

	Dec-16	Dec-17	Dec-18	Dec-19	LTM Mar-20
CFO Pre-W/C + Interest / Interest	5.6x	4.8x	5.0x	5.5x	4.8x
CFO Pre-W/C / Debt	21.2%	16.7%	15.7%	18.3%	11.1%
CFO Pre-W/C – Dividends / Debt	16.2%	11.9%	12.6%	13.8%	7.8%
Debt / Capitalization	42.1%	52.3%	54.9%	51.4%	58.9%

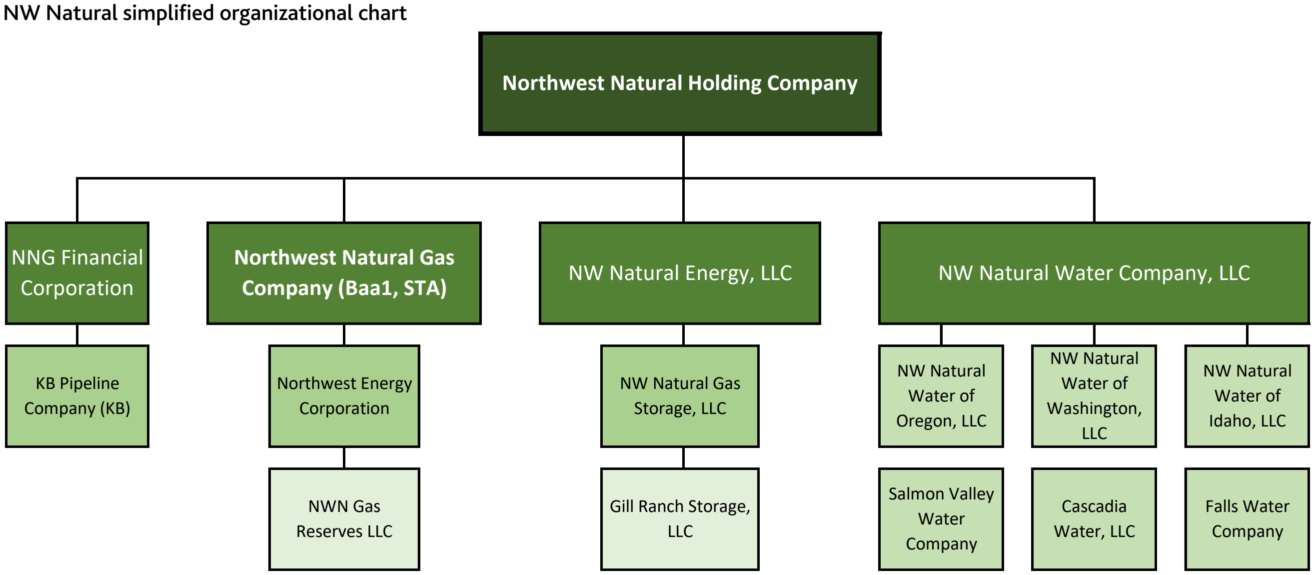
[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics

Profile

Northwest Natural Gas Company (NW Natural, Baa1 stable) is a natural gas local distribution company (LDC), serving over 760,000 customers in Oregon (about 90% of utility margins) and Washington (about 10% of utility margins). NW Natural is regulated by the Oregon Public Utility Commission (OPUC) and the Washington Utilities and Transportation Commission (WUTC).

NW Natural's parent, Northwest Natural Holding Company (unrated) is a holding company headquartered in Portland, Oregon and owns NW Natural, NW Natural Water Company, LLC (NWN Water, unrated), and other businesses and activities. NW Natural is NW Holdings' largest subsidiary and an illustrative organizational chart can be found below.

Exhibit 3
NW Natural simplified organizational chart



Source: NW Natural

Detailed credit considerations

Legislative and regulatory support evidenced in Oregon in recent months

NW Natural's low business risk profile is supported by gas distribution operations that receive supportive regulatory treatment from the Oregon Public Utility Commission (OPUC) and Washington Utilities and Transportation Commission (WUTC), which allows for several cost recovery mechanisms that help provide stability and predictability of the company's cash flow.

Regarding COVID-19 related matters, we expect that both states will provide some recovery of incremental costs associated with NW Natural's efforts to support customers during the pandemic. However, we also presume that the company will be exposed to the loss of commercial customers and increased bad debt expense, especially in Washington where rates are more sensitive to fluctuations in volume.

Oregon

Since 90% of the utility's margins are derived from Oregon customers, the legislative and regulatory support that NWN receives from the OPUC is a fundamental credit driver for the company. In general, NWN has cooperative relationships with stakeholders in the state and has been able to negotiate constructive rate case outcomes (e.g., important progress made with tax reform treatment and pension cost recovery in its October 2018 rate case and March 2019 settlement) and acquire tracking mechanisms for its most material costs.

The most important cost recovery mechanisms include: NW Natural's use of forward test years for capital expenditures; weather adjusted rate mechanism (WARM); conservation tariff (i.e., revenue decoupling); purchased gas adjustment (PGA); utility gas reserve investments included in rate base; and a Site Remediation and Recovery Mechanism (SRRM), primarily for the recovery of manufactured gas plant environmental expenditures. These various cost recovery mechanisms help support recovery of the most significant costs that NW Natural faces.

In December 2019, NW Natural filed for a $71.4 million increase in base rates based on a 10% return on equity ratio and 50% equity ratio. The rate case filing was driven by safety and reliability investments in the gas distribution system as well as the replacement of the dehydration system at the Mist underground storage facility. In April 2020 the OPUC staff and other intervenors filed a partial settlement recommending a $38 million in increase in base rates premised on a 9.4% ROE and 50% equity ratio. The settlement is still subject to OPUC approval and the company expects new rates to be effective 1 November 2020.

From a legislative perspective, Oregon has frequently been on the forefront of progressive environmental measures, including the 2019 passage of Senate Bill 98 (SB 98), which allows utilities to acquire renewable natural gas (RNG) on behalf of customers. Discussions are taking place currently, which will help to scope and define what these investments can consist of and how cost recovery will occur. We see this as an important step in supporting ongoing investment and growth for NW Natural in the face of the threat of electrification. The state support for RNG development can be a helpful tool for the company to maintain its place as a significant energy provider for customers at the same time as reducing carbon and methane emissions.

Washington

In October 2019, the WUTC approved a settlement that the company had reached with rate case intervenors, allowing NW Natural a $5 million annual rate increase based on a 49% equity layer, 9.4% allowed ROE on a total of nearly $174 million rate base. It also addressed customer benefits associated with tax reform and NW Natural's ability to recover environmental remediation costs.

However, the WUTC denied the implementation of a revenue decoupling mechanism, which would have helped NW Natural maintain more stable margins in the midst of changes in volumetric demand. While the addition of a decoupling mechanism would have been a credit enhancement, our view of NW Natural's operations in the state of Washington remains unchanged.

Core financial metrics are appropriate for NW Natural's credit profile, despite the sharp increase in Q1 2020 debt

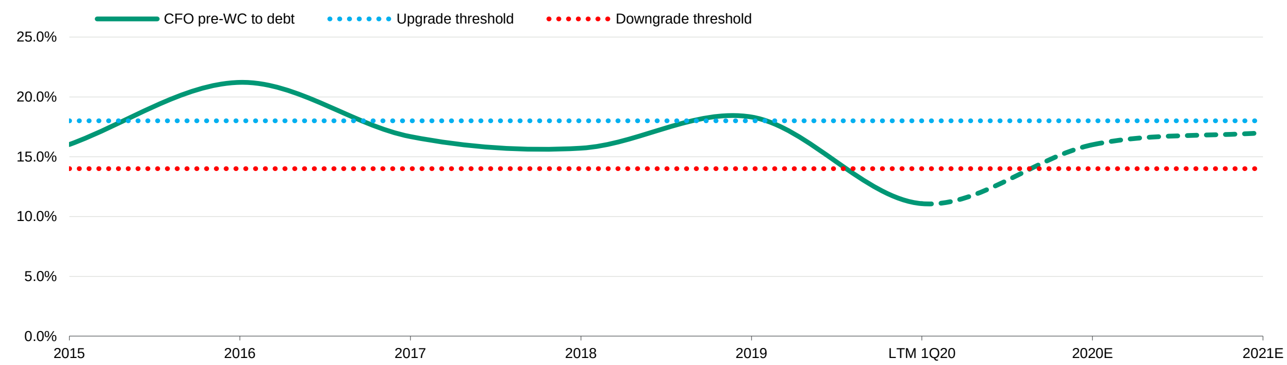
Due to volatile financial markets, including limited availability to issue commercial paper, in March and April 2020, NW Natural took a series of defensive financial measures in an effort to ensure adequate liquidity for the year and amid COVID-19 uncertainties. These measures include instituting a $150 million 364-day term loan and pre-funding $150 million of First Mortgage Bonds that were intended to be issued later in the year and borrowed roughly $227 million under its $300 million revolving credit facility.

The actions have increased current debt balances above typical levels and has resulted a in CFO pre-WC to debt metric of 11% for LTM Q1 2020. However, when calculating that ratio using a net debt figure, which reduces debt by the $432 million of cash on the Balance

Sheet at 31 March, 2020 (e.g,. the company typically carries under $10 million of cash for short-term operations), this metrics is around 15%.

While there are additional risks to NW Natural's financial profile due to the COVID-19 pandemic, we expect that the company's core financial potential remains intact over the longer-term. This expectation is based on the combination of the October 2018 and March 2019 regulatory outcomes, including incremental cash flow from its current rate filing, which should help the company to generate around $200 million of cash flow per annum and generate CFO pre-WC to debt around 16%, as seen in the exhibit below.

Exhibit 4
NW Natural's cash flow to debt profile is expected to remain consistent around 16-17%
CFO pre-WC to debt



LTM 1Q20 CFO pre-WC to net debt, reflecting $432 million of cash on balance sheet, would be 15%
Source: NW Natural SEC filings and Moody's Investors Service projections

ESG considerations

Environmental
NW Natural has low carbon transition risk within the utility sector because it is a gas LDC and natural gas commodity purchase costs are fully passed through to customers with an effective cost recovery mechanism. Moreover, we see NW Natural as one of the more active LDC's in the industry regarding proactive carbon transition activities. For example, the company has established a voluntary goal of 30% carbon savings (based on the level of emissions in 2015) by 2035 through reducing the carbon intensity of its supply chain and operations, enhancing the efficient use of the product and replacing natural gas for less carbon intensive fuels used by the company.

However, NW Natural will continue to have the overhang of environmental liabilities associated with legacy manufactured gas plants (MGPs) that release contaminants into surrounding areas. These liabilities may require a significant amount of environmental remediation, the costs for which are often uncertain and subject to the orders of the Environmental Protection Agency (EPA) and state environmental agencies. The cash outlay for these efforts can be substantial and require an ample amount of liquidity.

We view the SRRM to be an important mechanism since it allows for full cost recovery over time; however, we note that it does have a limited benefit to the company's near-term cash profile, since cash recovery occurs over a five year period. Therefore, if NW Natural were to incur a material level of costs in any given year, its cash and financial position would be impaired for some time as it waits for full recovery in authorized rates. We note that the company is able to collect interest on the balance outstanding - a positive.

Social
Social risks are primarily related to health and safety, demographic and societal trends, as well as customer relations as the company works to provide reliable and affordable service to customers and safe working conditions to employees. Regarding affordability, we see the potential for rising social risks associated with the COVID-19 pandemic and its effect on NW Natural's service territory, should unemployment remain high, making customers less able to absorb rate increases.

Governance

The company's governance is reflective of that of its parent, which has taken credit supportive efforts in the areas of financial and risk management. These efforts include bolstering its liquidity in the face of COVID-19 related financial market volatility, committing to carbon emission reductions throughout its system (in an effort to become more environmentally compliant and bolstering its competitive position in the energy space) and initiating a diversification strategy, by investing roughly $110 million in small water systems in the Pacific Northwest and Texas over the last few years.

Liquidity analysis

NW Natrual's internal liquidity consists of $432 million of cash on hand as of 31 March, which is sufficient to cover around $240 million of capital expenditures and dividends of at least $54 million (the amount paid through LTM Q1 2020), in addition to cash flow from operations of between $180 million and $200 million.

The company's external liquidity sources are somewhat depleted following Q1 2020 defensive measures to mitigate COVID-19 risks to the business. For example, the company drew around $227 million of its $300 million revolver, in addition to having roughly $27 million of commercial paper outstanding. However, we note that the $300 million committed credit facility (expires in March 2023) also contains features to increase the committed amount up to a maximum of $450 million and extend the commitments for two additional one-year periods. The primary restrictive covenant requires the company to maintain a debt to capitalization ratio of 70% or less, which NW Natural was in compliance with at 31 March 2020 (61.4%).

NW Natural's 2021 debt maturities include $10 million of senior debt in August and $50 million in September.

Rating methodology and scorecard factors

Exhibit 5

Rating factors

Northwest Natural Gas Company

Regulated Electric and Gas Utilities Industry Scorecard [1][2]	Current LTM 3/31/2020		Moody's 12-18 Month Forward View As of Date Published [3]	
Factor 1 : Regulatory Framework (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Legislative and Judicial Underpinnings of the Regulatory Framework	A	A	A	A
b) Consistency and Predictability of Regulation	A	A	A	A
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	Aa	Aa	Aa	Aa
b) Sufficiency of Rates and Returns	A	A	A	A
Factor 3 : Diversification (10%)				
a) Market Position	Baa	Baa	Baa	Baa
b) Generation and Fuel Diversity	N/A	N/A	N/A	N/A
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	4.9x	A	4.5x - 5x	A
b) CFO pre-WC / Debt (3 Year Avg)	14.6%	Baa	16% - 17%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	10.8%	Baa	11% - 13%	Baa
d) Debt / Capitalization (3 Year Avg)	54.2%	Baa	45% - 50%	A
Rating:				
Scorecard-Indicated Outcome Before Notching Adjustment		A3		A3
HoldCo Structural Subordination Notching		0		0
a) Scorecard-Indicated Outcome		A3		A3
b) Actual Rating Assigned		Baa1		Baa1

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 3/31/2020;
[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Source: Moody's Financial Metrics

Appendix

Exhibit 6

Cash Flow and Credit Metrics [1]

CF Metrics	Dec-16	Dec-17	Dec-18	Dec-19	LTM Mar-20
As Adjusted					
FFO	**204**	**190**	**195**	**219**	**202**
+/- Other	12	(4)	(4)	(2)	(18)
CFO Pre-WC	**216**	**186**	**192**	**217**	**184**
+/- ΔWC	21	37	(4)	(19)	12
CFO	**237**	**223**	**187**	**198**	**196**
- Div	52	54	38	53	54
- Capex	145	216	218	226	233
FCF	**41**	**(46)**	**(69)**	**(82)**	**(91)**
(CFO Pre-W/C) / Debt	21.2%	16.7%	15.7%	18.3%	11.1%
(CFO Pre-W/C - Dividends) / Debt	16.2%	11.9%	12.6%	13.8%	7.8%
FFO / Debt	20.0%	17.0%	16.0%	18.5%	12.1%
RCF / Debt	14.9%	12.2%	12.9%	14.0%	8.9%
Revenue	676	755	706	740	738
Cost of Good Sold	256	320	256	256	259
Interest Expense	47	49	48	48	49
Net Income	56	(61)	37	81	77
Total Assets	3,115	3,116	3,253	3,322	3,826
Total Liabilities	2,275	2,385	2,547	2,510	2,980
Total Equity	840	731	706	812	846

[1] All figures and ratios are calculated using Moody's estimates and standard adjustments. Periods are Financial Year-End unless indicated. LTM = Last Twelve Months.
Source: Moody's Financial Metrics

Exhibit 7

Peer Comparison Table [1]

	Northwest Natural Gas Company (P)Baa1 Stable			Questar Gas Company A3 Stable			Wisconsin Gas LLC A3 Stable			Southwest Gas Holdings, Inc. Baa1 Negative		
(in US millions)	FYE Dec-18	FYE Dec-19	LTM Mar-20	FYE Dec-17	FYE Dec-18	LTM Mar-19	FYE Dec-17	FYE Dec-18	FYE Dec-19	FYE Dec-17	FYE Dec-18	FYE Dec-19
Revenue	706	740	738	947	918	904	614	650	636	2,549	2,880	3,120
CFO Pre-W/C	192	217	184	184	166	196	139	140	127	568	586	577
Total Debt	1,219	1,185	1,663	1,111	904	887	708	784	845	2,697	2,930	3,192
CFO Pre-W/C / Debt	15.7%	18.3%	11.1%	16.6%	18.4%	22.1%	19.7%	17.9%	15.0%	21.1%	20.0%	18.1%
CFO Pre-W/C – Dividends / Debt	12.6%	13.8%	7.8%	16.6%	18.4%	22.1%	13.3%	11.5%	7.9%	17.7%	16.6%	14.4%
Debt / Capitalization	54.9%	51.4%	58.9%	52.7%	41.3%	39.4%	41.9%	42.9%	42.4%	54.2%	50.7%	50.1%

[1] All figures & ratios calculated using Moody's estimates & standard adjustments. FYE = Financial Year-End. LTM = Last Twelve Months. RUR* = Ratings under Review, where UPG = for upgrade and DNG = for downgrade
Source: Moody's Financial Metrics

Ratings

Exhibit 8

Category	Moody's Rating
NORTHWEST NATURAL GAS COMPANY	
Outlook	Stable
First Mortgage Bonds	A2
Senior Secured	A2
Senior Unsecured MTN	(P)Baa1
Pref. Shelf	(P)Baa3
Commercial Paper	P-2

Source: Moody's Investors Service

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