BEFORE THE

WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

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GENERAL RATE APPLICATION

OF

NORTHWEST NATURAL GAS COMPANY

December 18, 2020

Direct Exhibit of Brody J. Wilson

COST OF CAPITAL

Exh. BJW-3

S&P Global
Ratings

Research

Northwest Natural Gas Co.

Primary Credit Analyst:
Matthew L O'Neill, New York (1) 212-438-4295; matthew.oneill@spglobal.com

Secondary Contact:
Beverly R Gantt, New York + 1 (212) 438 1696; beverly.gantt@spglobal.com

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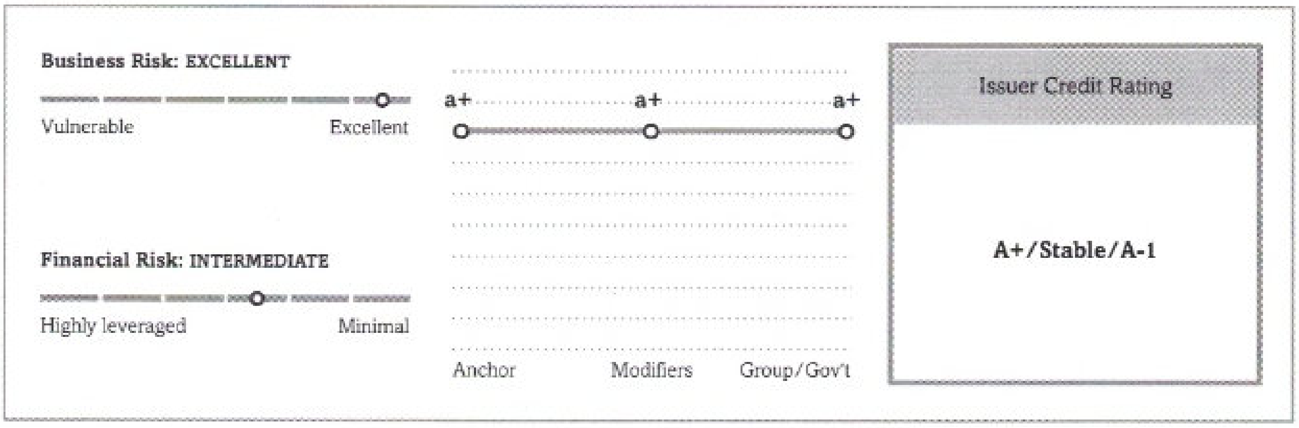
Northwest Natural Gas Co.



Credit Highlights

Overview

Key Strengths	Key Risks
Primarily low-risk natural gas distribution operations with limited unregulated storage operations.	Negative discretionary cash flow over the next few years, indicating external funding needs.
We expect financial measures to be stronger in 2019 as a result of rate case approvals in Washington and Oregon	Limited geographical and regulatory diversity.

Northwest Natural Gas Co. has a lower-risk business model and manages its regulatory risk effectively. This largely reflects the company's ability to get cost recovery for its investments in a timely manner, including through the use of various infrastructure riders that enable the utility to recover its investments on a more frequent basis. Our view of NWN's limited regulatory and geographic diversity reflects about 750,000 customers the company serves across two states. Oregon accounts for roughly 90% of the company's rate base. Washington accounts for the remainder.

We expect the company to maintain credit measures that are consistent with its current rating. Specifically, we expect the company to maintain funds from operations (FFO) to debt of about 15%-18%.

The company's strategy to acquire small water assets will likely be neutral to the ratings as long as the asset purchases are financed in a credit-supportive manner, and reflect low-risk regulated operations.

Outlook: Stable

The stable rating outlook on Northwest Natural Gas Co. (NWN) over the next two years reflects S&P Global Ratings' expectation of strong financial and operating performance and effective management of regulatory risk. We expect FFO to debt to range between 15%-18% over the next two years.

Downside scenario

Ratings pressure could occur over the next two years if FFO to debt consistently drops below 15%. This could occur if the company relies heavily on external financing to fund cash shortfalls, if investments in nonregulated operations exceed our expectations, or cash flows suffer due to mismanagement of regulatory risk.

Upside scenario

Although we consider an upgrade unlikely over the next two years, we could raise the ratings if the company improves financial measures on a sustained basis, including FFO to debt of more than 23%. This could occur through strengthened operating cash flow or reduced debt leverage.

Our Base-Case Scenario

Key Metrics

	2018a	2019e	2020e
FFO to Debt (%)	14.0	17.5-18.5	16.5-17.5
Debt to EBITDA (x)	5.0	4.0-5.0	4.0-5.0

a--Actual. e—Estimate.

Company Description

NW Natural Gas Co. operates as a regulated natural gas distribution company. The company serves approximately 740,000 natural gas customers in Oregon and Southwest Washington through 14,000 miles of pipeline systems in the United States

Business Risk: Excellent

We assess NWN's business risk based on the company's very low risk regulated gas distribution operations, which account for almost 100% of the consolidated cash flows. About 89% of NWN's roughly 750,000 customers are in Oregon, primarily in the Salem and Portland metropolitan areas; the remainder are in Washington. The company benefits from stable and supportive regulatory environments in both of the jurisdictions it operates in, with purchased gas adjustments and environmental cost deferral in both jurisdictions, and decoupling, a forward-looking test year, and a weather normalization mechanism in Oregon. These mechanisms reduce regulatory lag in the collection of associated costs and help bolster cash flow stability outside of rate cases. A large, stable residential customer base (about 90% of all customers) with limited exposure to more cyclical commercial and industrial customers further stabilizes the utility's cash flows. A history of safe and reliable services also strengthens the company's business profile. Because of these factors, we view the company's business risk profile at the stronger end of the excellent category, supported by the company's ability to effectively manage its regulatory risk.

The company has continued its strategy to diversify its business operations by purchasing small-regulated water utilities. Given the low-risk nature of water utilities, we view NWN's entry into the regulated water utility space as modestly positive for its business risk profile.

Peer comparison

Table 1

Northwest Natural Gas Co. -- Peer Comparison

Industry Sector: Gas

	Northwest Natural Gas Co.	**ONE Gas Inc.**	**Piedmont Natural Gas Co. Inc.**	**Atmos Energy Corp.**
Ratings as of March 19, 2020	A+/Stable/A-1	A/Stable/A-1	A-/Stable/A-2	A/Stable/A-1
	--Fiscal year ended Dec. 31, 2018--	**--Fiscal year ended Dec. 31, 2018--**	**--Fiscal year ended Dec. 31, 2018--**	**--Fiscal year ended Sep. 30, 2018--**
(Mil. $)				
Revenue	705.6	1,633.7	1,375.0	3,115.5
EBITDA	225.9	462.2	396.5	1,125.2
Funds from operations (FFO)	157.4	407.2	314.3	936.6
Interest expense	42.9	56.1	101.2	120.2
Cash interest paid	41.2	54.2	98.2	182.5
Cash flow from operations	173.0	468.4	464.3	1,129.6
Capital expenditure	214.3	391.1	704.0	1,460.8
Free operating cash flow (FOCF)	(41.4)	77.3	(239.7)	(331.2)
Discretionary cash flow (DCF)	(79.7)	(27.4)	(239.7)	(546.1)
Cash and short-term investments	7.9	21.3	0.0	13.8
Debt	1,120.7	1,621.4	2,312.0	3,680.2

Table 1

Northwest Natural Gas Co. -- Peer Comparison (cont.)				
Equity	715.7	2,042.7	2,091.0	4,770.0
Adjusted ratios				
EBITDA margin (%)	32.0	28.3	28.8	36.1
Return on capital (%)	8.0	8.0	5.7	9.2
EBITDA interest coverage (x)	5.3	8.2	3.9	9.4
FFO cash interest coverage (x)	4.8	8.5	4.2	6.1
Debt/EBITDA (x)	5.0	3.5	5.8	3.3
FFO/debt (%)	14.0	25.1	13.6	25.4
Cash flow from operations/debt (%)	15.4	28.9	20.1	30.7
FOCF/debt (%)	(3.7)	4.8	(10.4)	(9.0)
DCF/debt (%)	(7.1)	(1.7)	(10.4)	(14.8)

Financial Risk: Intermediate

Under our base-case scenario, with about $200 million in capital spending, about $55 million in dividends, and cost recovery through rate case filings, we expect the company's FFO to debt be in the middle of the range for an intermediate financial risk profile in 2020. Specifically, we expect FFO to debt to be around 16.5%-17.5%.

We assess NWN's financial risk profile using low volatility table, reflecting the low-risk nature of the company's natural gas distribution operations and effective management of regulatory risk. We assume NWN will continue to manage regulatory risk well and fully recover its capital spending on a timely basis.

Financial summary

Table 2

Northwest Natural Gas Co. -- Financial Summary					
Industry Sector: Gas					
	--Fiscal year ended Dec. 31--				
	2018	**2017**	**2016**	**2015**	**2014**
(Mil. $)					
Revenue	705.6	762.2	676.0	723.8	754.0
EBITDA	225.9	247.5	244.2	231.7	241.5
Funds from operations (FFO)	157.4	191.5	213.2	172.2	176.8
Interest expense	42.9	45.0	41.3	45.2	47.3
Cash interest paid	41.2	41.3	38.1	42.2	45.3
Cash flow from operations	173.0	205.6	225.5	187.5	218.5
Capital expenditure	214.3	211.0	139.5	119.9	146.9
Free operating cash flow (FOCF)	(41.4)	(5.4)	86.0	67.7	71.6
Discretionary cash flow (DCF)	(79.7)	(61.4)	34.5	18.4	21.5
Cash and short-term investments	7.9	3.5	3.5	4.2	9.5

Table 2

Northwest Natural Gas Co. -- Financial Summary (cont.)

Industry Sector: Gas

	--Fiscal year ended Dec. 31--				
	2018	**2017**	**2016**	**2015**	**2014**
Gross available cash	7.9	3.5	3.5	4.2	9.5
Debt	1,120.7	1,008.8	855.5	945.3	970.9
Equity	715.7	742.8	850.5	781.0	767.3
Adjusted ratios					
EBITDA margin (%)	32.0	32.5	36.1	32.0	32.0
Return on capital (%)	8.0	9.5	9.1	8.8	9.2
EBITDA interest coverage (x)	5.3	5.5	5.9	5.1	5.1
FFO cash interest coverage (x)	4.8	5.6	6.6	5.1	4.9
Debt/EBITDA (x)	5.0	4.1	3.5	4.1	4.0
FFO/debt (%)	14.0	19.0	24.9	18.2	18.2
Cash flow from operations/debt (%)	15.4	20.4	26.4	19.8	22.5
FOCF/debt (%)	(3.7)	(0.5)	10.1	7.2	7.4
DCF/debt (%)	(7.1)	(6.1)	4.0	1.9	2.2

Liquidity: Adequate

We assess liquidity as adequate for Northwest Natural Gas Co. because we believe sources are likely to cover uses by more than 1.1x over the next 12 months. We also project sources will meet cash outflows even in the event of a 10% decline in EBITDA. Our assessment also reflects the company's generally prudent risk management, sound relationships with banks, and generally satisfactory standing in credit markets.

Principal Liquidity Sources	Principal Liquidity Uses
• $7.9 million available cash balance as on Dec. 31, 2018; • Available credit facility of about $300 million annually; and • Cash FFO estimated to be about $193 million of about $400 million.	• Debt maturities of about $248 million; • Maintenance capital expenditure of about $150 million; and • Dividend payments of around $56 million.

Environmental, Social, And Governance

NWN's environmental exposure is in line with other regulated natural gas utility providers, including as it relates to methane emissions. This includes the potential for operational or financial risks to arise if regulation governing methane emissions become more restrictive.

Social and governance factors are neutral. NWN's track record of service reliability could support the company's ability to maintain social cohesion. Our views of NWN's governance are in line with other sector peers.

Group Influence

Under our group rating methodology, we view NWN as the parent and the ultimate rated entity. As a result, NWN's group and stand-alone credit profile are the same at 'a+'.

Issue Ratings - Subordination Risk Analysis

The short-term rating on NWN is 'A-1' based on our 'A+' issuer credit rating on the company.

Analytical conclusions

We rate the company's medium-term notes program 'A+', equal to its issuer credit rating, because we view any debt issued under this program as debt issued by a qualifying investment-grade utility.

Issue Ratings - Recovery Analysis

NWN'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 Northwest Natural Gas Co. Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. $)

	--Fiscal year ended Dec. 31, 2018--					
Northwest Natural Gas Co. reported amounts						
	Debt	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**
	951.6	218.1	133.1	37.0	225.9	173.5

Table 3

Reconciliation Of Northwest Natural Gas Co. Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. $) (cont.)

S&P Global Ratings' adjustments						
Cash taxes paid	--	--	--	--	(27.4)	--
Cash taxes paid: Other	--	--	--	--	--	--
Cash interest paid	--	--	--	--	(35.3)	--
Operating leases	82.1	5.4	5.9	5.9	(5.9)	(0.5)
Postretirement benefit obligations/deferred compensation	139.1	--	--	--	--	--
Accessible cash and liquid investments	(7.9)	--	--	--	--	--
Share-based compensation expense	--	2.5	--	--	--	--
Nonoperating income (expense)	--	--	3.8	--	--	--
Debt: Other	(44.1)	--	--	--	--	--
Total adjustments	169.1	7.9	9.7	5.9	(68.6)	(0.5)
S&P Global Ratings' adjusted amounts						
	Debt	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
	1,120.7	225.9	142.8	42.9	157.4	173.0

Ratings Score Snapshot

Issuer Credit Rating

A+/Stable/A-1

Business risk: Excellent

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

Financial risk: Intermediate

- **Cash flow/leverage:** Intermediate

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:** Satisfactory (no impact)

- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : a+

- **Group credit profile:** a+

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

Business And Financial Risk Matrix

	Financial Risk Profile					
Business 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 March 20, 2020)*	
Northwest Natural Gas Co.	
Issuer Credit Rating	A+/Stable/A-1
Commercial Paper	
Local Currency	A-1

Ratings Detail (As Of March 20, 2020)*(cont.)	
Senior Secured	AA-
Issuer Credit Ratings History	
25-Jan-2010	A+/Stable/A-1
19-Dec-2008	AA-/Negative/A-1+
28-Feb-2006	AA-/Stable/A-1+

*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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