

## Research

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### Research Update:

# Puget Energy Inc. 'BBB-' Ratings Affirmed; Outlook Stable

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## Research Update:

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## Overview

- Bellevue, Wash.-based Puget Sound Energy Inc. (PSE) recently received an order from the Washington Utilities and Transportation Commission (WUTC) on its general rate case, including an overall rate decrease and a plan to recover costs associated with PSE's closure of two coal plants by 2022.
- We are affirming our ratings on PSE parent Puget Energy Inc. (PE), including the 'BBB-' issuer credit rating. The outlook is stable.
- We are revising our business risk assessment on PE to excellent from strong, resulting in a revised stand-alone credit profile (SACP) for PE to 'bbb+' from 'bbb'.
- In addition, we are revising our management and governance (M&G) assessment of the company to satisfactory from fair.
- The stable outlook reflects a modest improvement in the company's business risk, which mitigates our assessment of PE's consolidated financial measures, including funds from operations (FFO) to debt of about 14.5%, indicative of the lower end of the range for the company's financial risk profile category.

## Rating Action

On Dec. 13, 2017, S&P Global Ratings affirmed its ratings on Puget Energy Inc. (PE), including the 'BBB-' issuer credit rating on PE, and 'BBB-' issue-level rating on PE's senior unsecured debt rating. The outlook is stable.

In addition, we revised our stand-alone credit profile for PE to 'bbb+' from 'bbb'. We also revised our M&G assessment on the company to satisfactory from fair.

## Rationale

The affirmation follows a recent regulatory order by the WUTC for subsidiary PSE that approves recovery of costs related to the future closure of the company's coal-fired generating units, Colstrip Units 1 and 2, despite the overall rate decrease.

Our revised business risk assessment for PE takes into account a modest improvement to PE's business risk reflecting the continued use of constructive regulatory mechanisms such as decoupling and various riders that we expect will provide stability to the company's profit measures going forward. In addition, our revised M&G assessment on the company to satisfactory from fair

reflects management's effectiveness in managing key regulatory risks associated with shutting down Colstrip Unit 1 and 2 by 2022.

PE's regulated subsidiary PSE sells electric and gas service to about 1.1 million electric customers, and about 800,000 gas customers, the vast majority of whom are residential customers, reflective of a mostly stable customer base that supports the company's credit quality.

We assess PE's financial risk using more moderate financial benchmarks than the typical corporate issuer. This reflects the company's mostly lower-risk, regulated business and its management of regulatory risk. Under our base-case scenario that includes capital spending of about \$970 million in 2018 and dividends of about \$115 million, we expect FFO to debt of about 14.5%, consistent with the lower end of the range for PE's financial risk profile category.

Our ratings on PE are lower by one notch to reflect our view of PE's business risk that we assess toward the lower end of the excellent category. PSE is susceptible to regulatory lag and unfavorable regulatory decisions, which dims our view of the company's overall management of regulatory risk in the state.

Our ratings for PE also reflect our assessment of Puget Holdings LLC (PH; not rated) as the ultimate parent of PE. We view PE as a core subsidiary of PH, reflecting our view that PH is highly unlikely to sell PE, that PE is integral to the group's strategy, and that PH has a strong long-term commitment to PE even under stressful conditions.

Our issuer credit rating on PE is one notch higher than the group credit profile because of the cumulative value of structural protections in place that insulate PE. We believe these restrictions would prevent PE from supporting the group to an extent that would unduly impair PE's stand-alone creditworthiness.

## **Liquidity**

PE has adequate liquidity in our view, and can cover its needs for the next 12 months, even if EBITDA were to decline by 10%. We expect the company's liquidity sources over the next 12 months will exceed uses by more than 1.1x. Under our stress scenario, we do not expect PE would require access to the capital markets to meet its liquidity needs during this period. Our assessment also reflects the company's generally prudent risk management, sound relationships with banks, and a generally satisfactory standing in the credit markets.

Principal liquidity sources:

- Consolidated credit facility availability of about \$1.6 billion;
- Cash FFO of about \$930 million; and
- Minimal cash

Principal liquidity uses:

- Capital spending of about \$970 million in 2018;
- Dividends of about \$115 million; and
- Consolidated debt maturities of about \$200 million in 2018.

## Outlook

The stable outlook reflects a modest improvement in the company's business risk, which mitigates our assessment of PE's consolidated financial measures, including FFO to debt of about 14.5%, indicative of the lower end of the range for the company's financial risk profile category.

### Downside scenario

We could lower the ratings over the next 12 to 18 months if PE's financial measures consistently weakened to the aggressive financial risk profile, reflecting FFO to debt of less than 13%. This could occur if the company's management of regulatory risk weakens.

### Upside scenario

We could raise the rating over the next 12 to 18 months if PE consistently improves its management of regulatory risk by further reducing regulatory lag. Alternatively, we could also raise the rating if the group credit profile improves.

## Ratings Score Snapshot

Corporate Credit Rating: BBB-/Stable/--

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)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Negative (-1)

Stand-alone credit profile: bbb+

- Group credit profile: bb+
- Entity status within group: Insulated (-2 notches from SACP)

## Issue Ratings

### Capital structure

PE's consolidated capital structure consists of about \$5.6 billion of debt, including about \$3.4 billion of first-mortgage bonds at PSE, and \$250 million of junior subordinated notes at PSE.

### Analytical conclusions

We rate PE's senior unsecured debt 'BBB-', the same as the the issuer credit rating on the company. Despite our preliminary notching outcome, PE's senior unsecured debt is rated the same as the issuer credit rating because of regulatory restrictions for PE that inhibit the company from supporting the group in a manner that unduly impairs PE's credit quality, mitigating subordination risk.

## Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- 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: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 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
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

## Ratings List

### Ratings Affirmed

Puget Energy Inc.

Corporate Credit Rating

BBB-/Stable/--

Senior Unsecured

BBB-

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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