

Research

Research Update:

Puget Energy Inc. Rating Raised To 'BBB-' On Revised Criteria; Puget Sound Energy Ratings Affirmed

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Overview

- Standard & Poor's Ratings Services published its revised Corporate ratings criteria on Nov. 19, 2013.
- We assess U.S.-based Puget Energy Inc.'s financial risk profile as "significant," based on cash flow measures that have improved over time.
- Puget Sound Energy Inc. is the sole subsidiary of Puget Energy Inc. Due to structural protections and dividend restrictions that insulate Puget Sound Energy Inc., and the strength of its stand-alone credit profile, the subsidiary's issuer credit rating is one notch higher.
- We are raising our ratings on Puget Energy Inc., including the corporate credit rating to 'BBB-' from 'BB+'. We also removed the ratings from CreditWatch, where we placed them with positive implications on Nov. 26, 2013, as a result of the new criteria. The rating outlook is stable. We are affirming our 'BBB' corporate credit rating on Puget Sound Energy Inc.
- The stable outlook is based on our expectation that the company will continue to effectively manage its regulatory risk, thereby supporting consistent operating results and a financial profile in line with expectations at the current ratings.

Rating Action

On Dec. 3, 2013, Standard & Poor's Ratings Services raised its corporate credit rating on Seattle-based utility holding company Puget Energy Inc. to 'BBB-' from 'BB+'. At the same time, we raised the rating on Puget Energy Inc.'s senior unsecured debt to 'BBB-' from 'BB+' and withdrew the '3' recovery rating on this debt. We removed all ratings from CreditWatch, where we placed them with positive implications Nov. 26, 2013. The outlook is stable. In addition, we affirmed the 'BBB' corporate credit rating on subsidiary Puget Sound Energy.

Rationale

We base our upgrade primarily on a reassessment of financial risk against our utilities medial volatility benchmarks, which recognize the lower volatility of cash flows in the regulated utility sector. The upgrade reflects our reassessment of the company's sustained improvement of its financial measures, which we believe will remain supportive of a "significant" financial risk profile, and "strong" business risk profile stemming from its strategic focus

on its core utility operations in a jurisdiction that has been challenging at times, as well as its ability to distribute both gas and electricity.

Standard & Poor's bases its ratings on Puget Energy Inc. and its subsidiary, Puget Sound Energy Inc., on the consolidated group credit profile and application of our Group Ratings Methodology. We deem Puget Sound Energy Inc. to be a "core" entity that is integral to the Puget Energy Inc. group. We rate the parent, Puget Energy Inc., one notch lower than the subsidiary, with the 'BBB-' representing the consolidated group credit profile. The parent derives 100% of its cash flow from the utility and there are structural protections and dividend restrictions in place that insulate the subsidiary.

Our "strong" business risk assessment on Puget Energy Inc. incorporates our assessment of "very low" industry risk of the regulated utility industry and a "very low" country risk based on the company's focus on U.S. operations and markets. Puget Energy Inc. is a utility holding company, whose sole subsidiary, Puget Sound Energy Inc. sells gas and electricity throughout much of the state of Washington. Our designation of Puget Energy Inc.'s business risk profile as "strong" incorporates our assessment of its strategy to focus exclusively on regulated utility operations in Washington. It is a relatively large utility, and though it only operates in a single, challenging jurisdiction, it sells both gas and electricity, providing some diversity. It faces risks related to hydroelectric power generation that are common in the Northwest.

Our assessment of Puget Energy Inc.'s "significant" financial risk profile is based on our expectation that operating results will benefit from recent improvements in recovery mechanisms issued by the state. For the 12 months ended Sept. 30, 2013, funds from operations (FFO) relative to total debt was 15.5%, and debt to EBITDA was 4.6x. We expect financial measures to remain strong with the advent of a decoupling mechanism and an attrition adjustment through a 2013 rate order, as well as expected decreases in capital spending related to the conclusion of an ambitious new generation campaign in recent years. The consolidated adjustments for Puget Energy Inc. reflect purchased-power obligations, operating leases, and pension-related items.

Our base-case projections assume:

- The economic conditions in the company's service territory continue to improve incrementally.
- EBITDA growth of about 3% per year.
- Puget Sound Energy has efficient electricity generating operations that produce competitively priced power, high levels of plant utilization, a low level of unforced outages, and high reliability. In addition, we view the gas distribution operations as having low operating risk.
- Puget's future capital spending will be more focused on pipeline replacement rather than on developing new generation; spending will likely be between \$500 million and \$650 million per year over the forecast period.

This results in the following credit measures:

- FFO to debt of between 14% and 16% during the next three years.
- FFO to interest coverage of more than 3.5x during the forecast period.

The ratings also reflect the application of a one-notch negative adjustment for our "comparable rating analysis". Despite the significant improvements in cash flows at the consolidated level in recent years, this is slightly weaker than comparably rated utility holding companies and it relies exclusively on dividends, which are restricted in some adverse circumstances.

Liquidity

We assess liquidity as "strong," based on our expectation of cash sources covering uses by at least 1.5x, the minimum required under our criteria. We expect manageable debt maturities in coming years and a sufficient ability to refinance loans where applicable, as well as a credit facility that is large for a utility of this size. Puget Energy continues to be able to issue debt in the capital markets when needed.

Sources:

- FFO of about \$1 billion over the next 12 months.
- Credit facility availability of nearly \$2 billion over the next 12 months.

Uses:

- Capital spending of between \$500 million and \$550 million over the next 12 months.
- Debt maturities of \$10 million over the next 12 months.
- Dividends of \$175 million over the next 12 months.

Outlook

The stable rating outlook on Puget Energy Inc. and its utility subsidiary Puget Sound Energy Inc. reflects our expectation that management will continue to reach constructive regulatory outcomes to avoid any palpable rise in business risk. The outlook also includes our projection of cash flow measures that, while lower than those of many utilities, are likely to stabilize in the coming period of lower capital spending. Given the company's exclusive focus on regulated utility operations, we expect that Puget Energy will avoid any meaningful changes in business risk and will fund upcoming capital investments in a balanced manner to support the capital structure.

Upside scenario

We could raise the ratings if financial measures consistently exceeded our baseline forecast, including FFO to total debt consistently greater than 16%. This would likely be the result of better-than-expected operational performance and new mechanisms that reduce regulatory lag, as well as capital spending that is lower than expected.

Downside scenario

We could lower ratings if financial measures weakened due to adverse regulatory outcomes and remained at less-supportive levels, including FFO to total debt consistently less than 13%. We could also lower ratings if the expected capital spending savings in coming years do not materialize.

Ratings Score Snapshot

Corporate Credit Rating: BBB-/Stable/---

Business risk: Strong

- Country risk: Low
- Industry risk: Low
- Competitive position: Satisfactory

Financial risk: Significant

Cash flow/leverage: Significant

Anchor: bbb

Modifiers:

Diversification/portfolio effect: Neutral (no impact)

Capital structure: Neutral (no impact)

Liquidity: Strong (no impact)

Financial policy: FS-4 (no impact)

Management and governance: Fair (no impact)

Comparable rating analysis: Negative (-1 notch)

Group Credit Profile: bbb-

Status within the group: Parent

Related Criteria And Research

- General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Nov. 19, 2013
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Nov. 19, 2013, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Corporate Methodology, Nov. 19, 2013
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008
- 2008 Corporate Criteria: Commercial Paper, April 15, 2008

Ratings List

Ratings Affirmed

Puget Sound Energy Inc.

Corporate Credit Rating

Senior Secured

BBB/Stable/A-2

A-

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Recovery Rating	1+
Senior Secured	A
Senior Unsecured	BBB
Junior Subordinated	BB+
Commercial Paper	A-2

Ratings Raised; Off CreditWatch

	To	From
Puget Energy Inc.		
Corporate Credit Rating	BBB-/Stable/--	BB+/Watch Pos/--
Senior Secured	BBB-	BB+/Watch Pos

Recovery Rating Withdrawn

	To	From
Puget Energy Inc.		
Senior Secured		
Recovery Rating	NR	3

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