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CREDIT OPINION
5 February 2018

Update

Rate this Research

RATINGS

Avista Corp.

Domicile	Spokane, Washington, United States
Long Term Rating	Baa1
Type	LT Issuer Rating
Outlook	Negative

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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AVISTA CORP.

Update following outlook change to negative

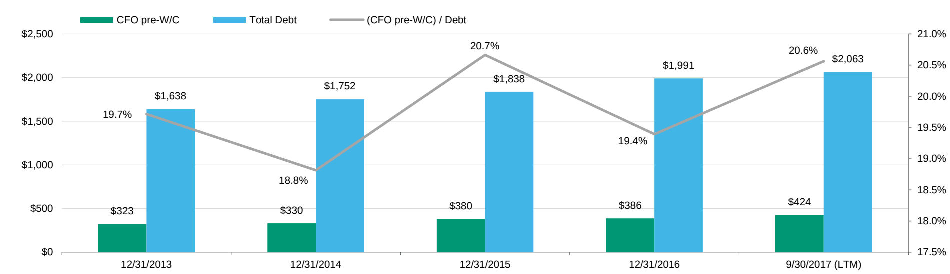
Summary

Avista Corporation's (Avista) credit profile reflects its primary business as a low-risk vertically integrated electric and gas utility with supportive cost recovery mechanisms, such as electric and gas revenue decoupling. Regulatory developments in Washington, Avista's primary regulatory jurisdiction, create some uncertainty for the company going forward. In addition we expect Avista's credit profile to be pressured by recently enacted tax reform given the high contribution of deferred income taxes to its operating cash flows.

On 19 July 2017, Canadian electric utility Hydro One, Ltd. (HOL unrated) announced it had reached an agreement to acquire Avista for $53 per share in a $5.3 billion all-cash transaction, including the assumption of roughly $1.9 billion of Avista reported debt. Our assessment of Avista's credit profile assumes that there will be no acquisition debt issued at the Avista level and that there will be no significant change to Avista's regulated capital structure and dividend policy as a result of the acquisition.

Avista has some unregulated exposure in addition to its ownership of regulated utility Alaska Electric Light and Power (AEL&P, Baa3 stable), which provide marginal operational and cash flow diversity, but remain neutral in terms of our view of Avista's credit.

Exhibit 1
Historical CFO Pre-WC, Total Debt and CFO Pre-WC to Debt
$ in millions



Source: Moody's Investors Service

Credit Strengths

» Low-risk utility with supportive cost recovery mechanisms

» Track record of stable cash flow generation

Credit Challenges

- » Concerns around management of regulatory relationships in Washington
- » Reduction in contribution of deferred taxes to operating cash flow as a result of tax reform
- » Some uncertainty over degree to which Avista may be required to support HOL acquisition debt

Rating Outlook

The negative outlook reflects the expected reduced contribution of deferred taxes to operating cash flow and regulatory uncertainty related to the ongoing Washington rate case. We project weaker credit metrics going forward, with CFO pre WC to debt falling to or below our previously communicated 17% threshold in the absence of actions to mitigate tax reform impacts and without adequate regulatory relief in Washington. In addition, Avista's credit profile would be negatively affected by any indication that it would be required to support HOL's acquisition debt. The outlook could be stabilized if Avista receives sufficient regulatory relief in Washington or if state-level regulatory and corporate financial actions are taken to offset the negative tax reform impact such that CFO pre WC to debt remains consistently at or above 18%.

Factors that Could Lead to an Upgrade

- » Demonstrated improvement in regulatory relationships
- » CFO pre-WC to debt above 21% on a sustainable basis
- » CFO pre-WC less dividends above 17% on a sustained basis

Factors that Could Lead to a Downgrade

- » Sustained depredation of regulatory relationships in Washington resulting in inadequate regulatory relief
- » CFO pre-WC to debt at 17% or below on a consistent basis
- » Direct financial support of HOL's acquisition debt

Key Indicators

Exhibit 2

KEY INDICATORS [1]
Avista Corp.

	12/31/2013	12/31/2014	12/31/2015	12/31/2016	9/30/2017(LTM)
CFO pre-WC + Interest / Interest	5.0x	5.2x	5.7x	5.4x	5.4x
CFO pre-WC / Debt	19.7%	18.8%	20.7%	19.4%	20.6%
CFO pre-WC – Dividends / Debt	15.2%	14.3%	16.2%	15.0%	16.1%
Debt / Capitalization	46.7%	44.6%	44.8%	44.5%	44.6%

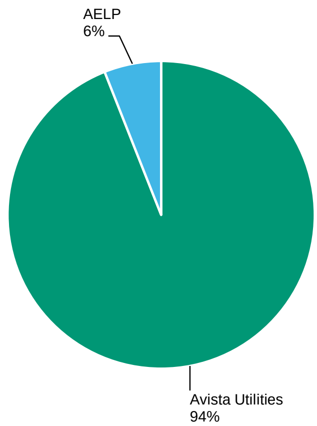
[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics™

Profile

Avista Corporation is primarily a regulated electric and gas utility servicing around 377,000 electric and 340,000 gas customers in Washington, Idaho and Oregon. Avista also owns Alaska Energy and Resources Company (AERC; not rated), parent of Alaska Electric Light and Power Company (AEL&P; Baa3 stable) which serves around 17,000 electric customers in Juneau, Alaska.

Avista's utility operations are primarily regulated by the Washington Utilities and Transportation Commission (WUTC), the Idaho Public Utilities Commission (IPUC) and the Oregon Public Utility Commission (OPUC). AEL&P is under the purview of the Regulatory Commission of Alaska (RCA).

Exhibit 3
2016 Earnings Contribution



Excludes Other Segment
Source: Avista Corporation

Detailed Credit Considerations

DIRECT SUPPORT OF HYDRO ONE'S ACQUISITION FINANCING WOULD BE CREDIT NEGATIVE

At announcement of its acquisition of Avista, HOL indicated that the $3.4 billion equity purchase price would be financed with the issuance of nearly $2.6 billion of HOL debt in addition to CAD1.4 billion of contingent convertible debentures. HOL announced a bought deal offering of the CAD1.4 billion convertible debentures at transaction announcement, and the offering closed on August 9, 2017. In total, the announced acquisition is credit negative for both HOL and its primary subsidiary Hydro One Inc. (HOI A3 negative) and potentially for Avista because of the significant amount of debt issued at the parent entity used to finance the acquisition. However, as currently envisioned, we expect that the transaction debt will be a direct obligation of HOL, a much larger holding company, and that it will not materially change Avista's financial obligations in terms of support. This is because HOL's primary credit support is derived from HOI's CAD$17.8 billion rate base and over CAD$721 million of annual net income that can be used to service HOL's debt obligations.

A dependence on Avista to support HOL's acquisition debt would be a material credit negative for Avista. Illustratively, Avista's cash flow to debt coverage would decline to a low of approximately 8%, a level not supportive of an investment grade credit profile, should all of the $2.6 billion of acquisition debt be imputed to Avista. While Avista's own balance sheet is protected to some degree by state regulatory commission oversight, we would see any significant linkage between Avista and acquisition-related debt support as a drag on Avista's overall credit quality.

The transaction has been approved by Avista shareholders and the U.S. Federal Energy Regulatory Commission (FERC). Regulatory approvals have been filed for, and are pending from the state utility commissions in Washington, Idaho, Oregon, Montana, and Alaska and the transaction is expected to close in the second half of 2018.

CREDIT SUPPORTIVE COST RECOVERY MECHANISMS

We view Avista's regulatory jurisdictions to be generally credit supportive. The Washington Utilities and Transportation Commission (WUTC), which regulates roughly 60% of the company's revenue, has electric and gas decoupling mechanisms which allow for timely recovery of fixed costs for the utility and drive stable and predictable gross margin and cash flow in the face of declining use, in addition to attrition adjustments for ongoing rates. Even though we view the Washington regulatory environment as generally credit supportive, the progress of Avista's most recent rate case in WA, discussed in the next section, raise some concern around the utility's management of its regulatory relationships in WA.

In Idaho, Avista was authorized electric and gas decoupling mechanisms in December 2015 for a three year period beginning January 1, 2016. In December 2017, the IPUC approved a multi-party settlement to increase annual electric base revenues by $12.9 million and $4.5 million and gas base revenues by $1.2 million and $1.1 million effective 1 January 2018 and 1 January 2019 respectively. Both electric and gas revenue increases are based on a 9.5% ROE and 50% equity ratio relative to a requested 9.9% ROE and 50% equity ratio. The authorized electric revenue increase was more than half of Avista's filed request for a $28 million increase and the authorized gas rate increase was approximately 40% of Avista's request for a $5.6 million gas revenue increase.

As part of its March 2016 rate case order in Oregon, Avista is now allowed to implement a revenue-per-customer decoupling mechanism. In September 2017, the OPUC approved a settlement to increase natural gas base revenues by $3.5 million based on a 9.4% return on equity (ROE) and a 50% equity ratio, with an increase of $2.6 million effective on 1 October 2017 and an increase of $0.9 million effective on 1 November 2017.

In Alaska, the RCA approved an all-party settlement in November 2017, authorizing a $1.3 million base rate increase, based on an 11.95% ROE and 58.18% equity ratio, in line with interim rates that went into effect in November 2016. The authorized return is significantly above the average of recently authorized returns for the industry, a credit positive. However, we note that Alaska has a statutory period of 450 days or approximately 15 months to decide on rate cases, the longest in the nation and has not authorized cash flow stabilizing mechanisms such as revenue decoupling.

WASHINGTON RATE CASE STILL PENDING FOLLOWING REJECTION OF INITIAL RATE FILING

In Washington, Avista's February 2016 rate filing was rejected by the WUTC in December 2016, followed by a WUTC denial for reconsideration of the December decision in February 2017. This was a surprising outcome considering our view that a core competency of utility management is managing regulatory relationships, making an outright denial by the regulator unusual and unexpected.

In an attempt to address WUTC concerns, Avista filed new electric and gas general rate cases in May 2017 requesting total electric and gas rate increases of approximately $90 million and approximately $17 million, respectively, in a three-step plan spanning May 2018 to May 2020. Both electric and gas filings propose a 9.9% allowed ROE with a 50% common equity ratio, compared to the currently allowed in rates 9.5% and 48.5% respectively.

On 21 October 2017, WUTC staff recommended a total gas rate increase of $6.6 million for the May 2018 to May 2020 period based on a 9.1% ROE and 48.5% equity ratio. The staff also recommended, on 6 November 2017, a total electric rate increases of approximately $29 million for the three year period, based on a 9.1% ROE and 48.5% equity ratio. Avista revised its initial revenue requirement in rebuttal testimony on 1 December 2017 and is currently requesting total electric and gas rate increases of approximately $82 million and approximately $14 million, respectively, based on a 9.9% ROE and 48.5% equity ratio. A final order on the rate case is expected in April 2018.

Details of the requested annual increases and WUTC recommendations are outlined in Exhibit 4 below.

Exhibit 4
WA Revenue Increase Request Update

	Electric				Natural Gas			
Effective Date	Filed Revenue Increase 26 May 2017	Filed Base % Increase	WUTC Staff Recommendation 6 November 2017	Rebuttal Revenue Increase 1 December 2017	Filed Revenue Increase 26 May 2017	Filed Base % Increase	WUTC Staff Recommendation 21 October 2017	Rebuttal Revenue Increase 1 December 2017
1-May-18	$61.4 M	12.50%	$10.0 M	$54.4M	$8.3M	9.30%	$1.1 M	$6.6 M
1-May-19	$14.0 M*	2.50%	$9.5 M	$13.5 M	$4.2M	4.40%	$2.7 M	$3.7 M
1-May-20	$14.4 M*	2.50%	$9.7 M	$13.9 M	$4.2 M	4.40%	$2.8 M	$3.8 M

* Excludes power supply adjustment
Source: Avista Corp., S&P Global Market Intelligence

Since the WUTC is Avista's most important regulator, overseeing roughly 60% of the company's revenue generation, a strong regulatory relationship with the WUTC is important for Avista's credit and adequate regulatory relief will be essential to the company's ability to maintain a stable financial profile over the next 12-24 months.

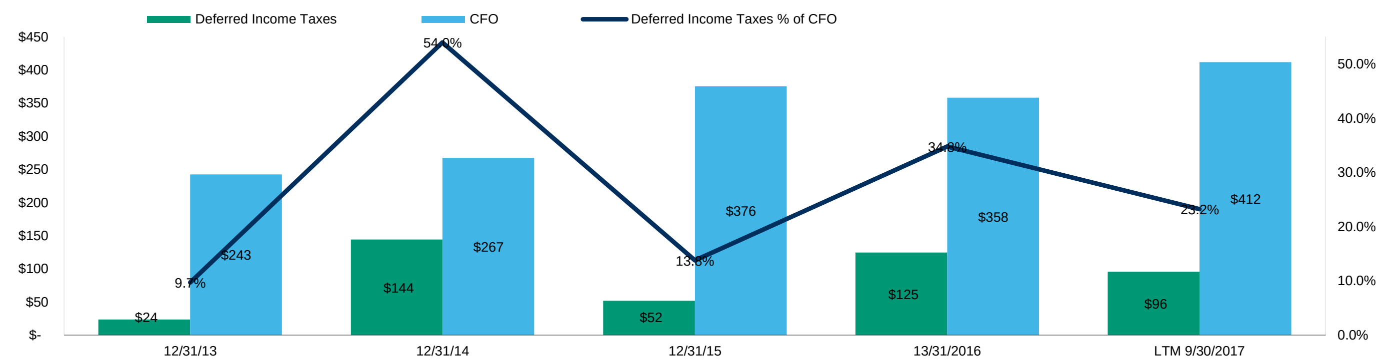
FINANCIAL PROFILE EXPECTED TO BE PRESSURED BY TAX REFORM

As of 30 September 2017 (LTM), Avista's key financial metrics continue to be stable, with cash flow from operations before the changes in working capital (CFO pre-WC) to debt at 20.6%. This level is in-line with other Baa1 vertically integrated peers and without the impact of recently enacted tax reform, could have been sufficient to support the company's current credit profile in spite of the delay in regulatory relief in WA and should the outcome of the rate case be slightly less favorable than expected.

For 2017, the earnings impact of the delayed rate relief in WA was offset by recent rate increases in Idaho and Oregon, as well as strong power supply conditions, including higher than expected hydro generation and lower gas prices. However, we anticipate that credit metrics will be pressured under normal power supply conditions if regulatory relief from WA is insufficient. In addition, for the next 12-18 months, we project a decline in Avista's credit metrics as a result of tax reform. Deferred income taxes have constituted a significant portion of Avista's operating cash flow, over a third of operating cash flow in 2016, approximately 23% as of LTM 30 September 2017 and averaging about 27% over the 2013 to LTM 30 September 2017 period. With the lower tax rate and loss of bonus depreciation from tax reform, we project cash flow to debt coverage around 16-17% over the next two years.

Exhibit 5

Avista Corp. Deferred Income Taxes Contribution to Operating Cash Flow (CFO)
($ in millions)



Source: Moody's Financial Metrics™

RECENT DEVELOPMENTS IN WASHINGTON'S CLEAN AIR RULE ARE POSITIVE FOR AVISTA

In September 2016, the Washington State Department of Ecology adopted the Clean Air Rule (CAR) which establishes emission standards for green house gas (GHG) emissions from certain sources in the state, including power plants and natural gas distributors. The plan called for a reduction of GHG emissions over time, at a pace of 1.7% annually until 2035.

Avista projects approximately 2.4 million metric tons of GHG emissions in 2018 from owned and controlled resources. This includes emissions from approximately 550 MW net capacity Avista-owned gas power plants (excludes Kettle Falls plant) and Avista's 222 MW net capacity share (15% ownership) of units 3 and 4 of the Colstrip coal power plant. It also includes emissions from the 270 MW Lancaster gas plant whose output is contracted to Avista through 2026 under a power purchase agreement. We view the ability to reduce emissions from owned generation as more feasible than from natural gas deliveries - which are primarily based on customer needs and generally outside the control of the company - since the company only acts as a conduit for natural gas deliveries. Therefore, it would be a credit negative if Avista was held financially accountable for the emissions of roughly 117 Bcf of gas deliveries per year, resulting in increased rates and customer bills with no added benefit of service.

In a positive development for Avista and other affected parties, the rule's compliance requirements have been suspended following a court ruling on parts of the CAR by the Thurston County Superior Court on 15 December 2017. The ruling favored employer groups which sued in 2016, arguing that the state Department of Ecology did not have the authority to enforce CAR without legislative approval. Further, the ruling judge agreed that the state could not impose emission reductions on non-fuel burning gasoline and natural-gas distributors and similar businesses.

Liquidity Analysis

We expect Avista to maintain adequate liquidity over the next 12-18 months.

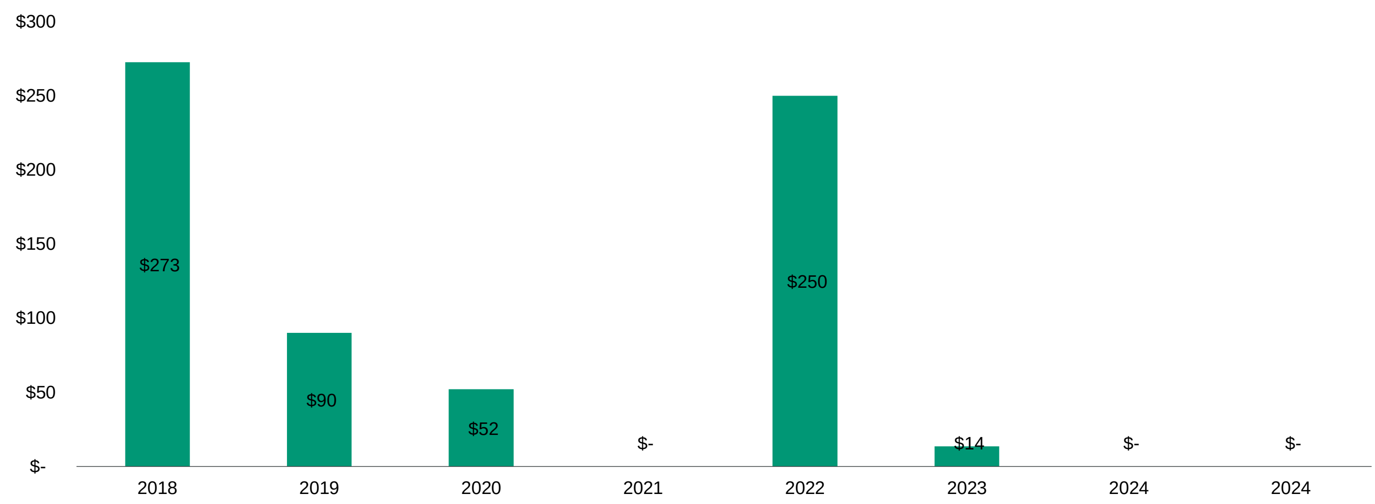
Avista's external liquidity sources consist of a $400 million senior secured revolving credit facility, which expires in April 2021. At the end of 2017, there was $260 million available under the line of credit. Since Avista currently has unsecured investment grade ratings from two nationally recognized rating agencies, the company has the option to request the banks to relinquish the existing First Mortgage Bond collateral position, but it has chosen not to do so for economic reasons. Despite the collateral staying in place at Avista's discretion, the secured nature of the credit facilities somewhat constrains Avista's liquidity flexibility, in our opinion, since the typical investment grade issuer (having an unsecured facility) can use collateral as an option to improve bank credit access during periods of unforeseen liquidity stress.

Avista was in compliance with the facility's sole covenant of less than 65% capitalization, with a ratio of 53.6% as of 30 September 2017. We note that the company has no material adverse change language beyond the close of the facility - a credit positive.

AEL&P has a $25 million line of credit which expires in November 2019 and requires a consolidated debt to capitalization covenant of 67.5%. As of 31 March 2017, there were no borrowings or letters of credit outstanding under the facility and AEL&P was in compliance with its covenant, with a ratio of 53.9%.

Avista's next material debt maturities occur in May and June 2018, when $7 million and an aggregate of around $265.5 million of senior debt is due, respectively. We expect that Avista will address upcoming maturities with planned debt issuances in 2018. The company also issued $55 million of equity in the fourth quarter of 2017.

Exhibit 6
Avista Corp. Debt Maturities
($ in millions)



* Excludes debt maturities of $15 million at Alaska Energy and Resources Company in 2019
Source: Avista Corporation

Methodology and Scorecard

Exhibit 7

Rating Factors				
Avista Corp.				
Regulated Electric and Gas Utilities Industry Grid [1][2]	Current LTM 9/30/2017		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	Baa	Baa	Baa	Baa
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	Baa	Baa	Baa	Baa
b) Sufficiency of Rates and Returns	Baa	Baa	Baa	Baa
Factor 3 : Diversification (10%)				
a) Market Position	Baa	Baa	Baa	Baa
b) Generation and Fuel Diversity	A	A	A	A
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	5.6x	A	4.4x - 4.8x	A
b) CFO pre-WC / Debt (3 Year Avg)	20.6%	Baa	15% - 17%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	16.1%	Baa	11% - 13%	Baa
d) Debt / Capitalization (3 Year Avg)	44.3%	A	47% - 49%	Baa
Rating:				
Grid-Indicated Rating Before Notching Adjustment		Baa1		Baa1
HoldCo Structural Subordination Notching		0	0	0
a) Indicated Rating from Grid		Baa1		Baa1
b) Actual Rating Assigned		(P)Baa1		(P)Baa1

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 9/30/2017 (LTM)
[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 8
Peer Comparison

	Avista Corp. Baa1 Negative			Puget Sound Energy, Inc. Baa1 Stable			Idaho Power Company A3 Stable			Portland General Electric Company A3 Stable		
(in US millions)	FYE Dec-15	FYE Dec-16	LTM Sep-17	FYE Dec-15	FYE Dec-16	LTM Sep-17	FYE Dec-15	FYE Dec-16	LTM Sep-17	FYE Dec-15	FYE Dec-16	LTM Sep-17
Revenue	1,485	1,442	1,450	3,093	3,165	3,373	1,268	1,259	1,333	1,898	1,923	2,018
EBITDA	418	473	481	1,125	1,260	1,240	483	477	515	657	693	739
(CFO Pre-W/C) / Debt	20.7%	19.4%	20.6%	20.1%	21.6%	24.2%	16.0%	15.1%	18.2%	21.6%	19.3%	21.1%
(CFO Pre-W/C - Dividends) / Debt	16.2%	15.0%	16.1%	13.5%	15.3%	20.2%	11.4%	10.2%	13.1%	17.8%	15.3%	16.9%
Debt / EBITDA	4.4x	4.2x	4.3x	3.7x	3.3x	3.3x	4.4x	4.6x	4.2x	3.8x	3.9x	3.7x
Debt / Book Capitalization	44.8%	44.5%	44.6%	45.5%	44.4%	42.6%	40.1%	39.4%	38.8%	46.8%	47.4%	46.9%
EBITDA / Interest Expense	5.2x	5.4x	5.0x	4.6x	5.3x	5.3x	4.6x	4.5x	4.8x	4.8x	5.2x	5.2x

[1] All figures & ratios calculated using Moody's estimates & standard adjustments. FYE = Financial Year-End. LTM = Last Twelve Months.
Source: Moody's Financial Metrics™

Exhibit 9
Cash Flow and Credit Measures [1]
($ in millions)

CF Metrics	2013	2014	2015	2016	2017
As Adjusted					
EBITDA	**387**	**401**	**418**	**473**	**481**
FFO	**298**	**330**	**386**	**442**	**428**
- Div	73	78	82	87	91
RCF	**224**	**251**	**304**	**355**	**337**
FFO	298	330	386	442	428
+/- ΔWC	(48)	(50)	(4)	(28)	(13)
+/- Other	25	-	(6)	(56)	(4)
CFO	**275**	**280**	**376**	**358**	**412**
- Div	73	78	82	87	91
- Capex	310	328	394	407	407
FCF	**(109)**	**(127)**	**(101)**	**(136)**	**(86)**
Debt / EBITDA	4.2x	4.4x	4.4x	4.2x	4.3x
EBITDA / Interest	4.8x	5.2x	5.2x	5.4x	5.0x
FFO / Debt	18.2%	18.8%	21.0%	22.2%	20.7%
RCF / Debt	13.7%	14.3%	16.5%	17.8%	16.3%

[1] All figures & ratios calculated using Moody's estimates & standard adjustments.
Source: Moody's Financial Metrics™

Ratings

Exhibit 10

Category	Moody's Rating
AVISTA CORP.	
Outlook	Negative
Issuer Rating	Baa1
First Mortgage Bonds	A2
Senior Secured	A2
Senior Unsecured MTN	(P)Baa1
ALASKA ELECTRIC LIGHT AND POWER COMPANY(AELP)	
Outlook	Stable
Issuer Rating	Baa3
AVISTA CORP. CAPITAL II	
Outlook	Negative
BACKED Pref. Stock	Baa2

Source: Moody's Investors Service

REPORT NUMBER 1109174

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Asia Pacific	852-3551-3077
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