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Research Update:

Avista Corp. Rating Affirmed At 'BBB' After Review; Outlook Stable

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Research Update:

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Overview

- We are affirming our credit ratings on U.S. integrated electric and gas utility Avista Corp. after a review. These include the 'BBB' issuer credit rating, the 'A-' first mortgage bond rating with a recovery rating of '1+', and the 'A-2' short-term rating. We revised the liquidity assessment to adequate from strong based on current estimates of uses such as capital spending, debt maturities, short-term borrowings, and dividend payments. The outlook remains stable.
- The stable outlook reflects our expectation that the company will continue to effectively manage regulatory risks, fund capital spending in a manner that does not meaningfully increase leverage, maintain adequate liquidity, and maintain comparable financial performance. We also expect no material increase in business risk through expansion into nonutility operations. Under our base-case scenario, we expect funds from operations to total debt to average about 18%.

Rating Action

On May 26, 2016, S&P Global Ratings affirmed its ratings on Avista Corp., including the 'BBB' issuer credit rating, the 'A-' first mortgage bond rating with a recovery rating of '1+', and the 'A-2' short term rating. The outlook is stable. In addition, we revised the liquidity assessment to adequate from strong.

Rationale

In our assessment, Avista's business risk profile is strong, reflecting its lower–risk, vertically integrated electric and natural gas distribution utility operations in Washington and Idaho, electric operations in Alaska, and gas distribution in Oregon. Although the company operates in four states, it has fewer than 400,000 electric and about 330,000 natural gas customers with no meaningful industrial concentration. When needed, the utility requests cost recovery from regulators. Because the utility has hydroelectric power exposure, recovery mechanisms are important to maintain operating cash flow after purchasing power for customers when hydroelectric generation is unavailable. The company has some flexibility in implementing incremental rate changes through its energy-recovery mechanism in Washington and the power cost adjustment in Idaho, but the recovery of excess power costs is subject to minimum thresholds and deferral bands. Purchased gas adjustments for gas distribution units in all three gas jurisdictions, along with hedging, mitigate gas price risk. These help avert large cost-adjustment requests and support the business risk profile. Decoupling mechanisms smooth out operating cash flow in all jurisdictions except Alaska.

Our financial risk profile assessment of significant takes into consideration the mostly steady cash flows from the utility business. Our base case indicates that capital spending along with dividend payments will lead to negative discretionary cash flow over the next few years. Avista will need external funding to cover the deficit because internally generated cash flow is insufficient. Our base-case scenario suggests stronger financial measures over the next two years, including funds from operations (FFO) to debt of roughly 18%, mainly benefiting from higher deferred taxes due to bonus depreciation. Our base case indicates an expected supplemental ratio of operating cash flow to debt of about 16% to about 18%, bolstering the significant financial risk profile assessment.

Liquidity

Avista has an adequate liquidity assessment because in our view its sources are likely to cover uses by more than 1.1x over the next 12 months and to meet cash outflows, even with a 10% decline in EBITDA. The adequate assessment also reflects the company's generally prudent risk management, sound relationships with banks, and a generally satisfactory standing in credit markets. Avista recently extended the maturity of its credit facilities to 2021.

Principal liquidity sources:

- We estimate FFO of about $360 million for the 12 months ending March 31, 2017.
- Revolving credit facility of $425 million.
- Cash on hand of roughly $10 million.

Principal liquidity uses:

- Capital spending of about $350 million for the 12 months ending March 31, 2017.
- Dividends of roughly $85 million for the 12 months ending March 31, 2017.
- Debt maturities of about $195 million, including short–term borrowings.

We rate the preferred securities at Avista Capital II two notches below the issuer credit rating to reflect the discretionary nature of the dividend and the deeply subordinated claim if a bankruptcy occurs.

The short-term rating on Avista is 'A-2' based on the issuer credit rating and our assessment of its liquidity as at least adequate.

Other Credit Considerations

Other modifiers do not affect the rating outcome.

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Group Influence

Avista is subject to the group rating methodology criteria. We view Avista as the parent that drives the group credit profile. As a result, Avista's group and stand-alone credit profiles are the same at 'bbb'.

Outlook

The stable outlook on Avista reflects our expectation that over the next two years the company will continue to effectively manage regulatory risks, fund capital spending such that leverage does not meaningfully increase, preserve adequate liquidity, and maintain comparable financial performance. We also expect no material increase in business risk through expansion into nonutility operations. Under our base-case scenario, we expect FFO to total debt to average about 18%.

Downside scenario

We could lower the rating in the next two years if business risk materially rises or credit measures diminish such that FFO to debt would be consistently less than 15%. This could occur due to greater borrowing or increased rate lag, a large deferral, or adverse regulatory decisions.

Upside scenario

In the next two years, we do not currently contemplate an upgrade given the company's current business mix. Credit quality could strengthen if cash flow measures considerably improve, specifically FFO to debt of more than 20% on a consistent basis. The company could accomplish this by paying down debt with higher internally generated cash flow or increased equity, or by boosting FFO without adding debt.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Stable/A-2

Business risk: Strong
- Country risk: Very low
- Industry risk: Very 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)
- 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: 'bbb'
- Group credit profile: 'bbb'

Recovery Analysis

Avista'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 two notches above the issuer credit rating.

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Collateral Coverage And Issue Notching Rules For ‘1+’ And ‘1’ Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed
Avista Corp.

Corporate Credit Rating	BBB/Stable/A-2
Senior Secured Rating	A-
Recovery Rating	1+

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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column.