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Ratings

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Research Update:

Avista Corp. Outlook Revised To Positive From Stable On Planned Acquisition By Hydro One Ltd.

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Research Update:

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Overview

- Toronto, Ontario-based utility Hydro One Ltd. (HOL) has entered into an agreement to acquire U.S.-based Avista Corp. (Avista) for C$6.7 billion in an all-cash transaction.
- We are affirming our ratings on Avista, including the 'BBB' issuer credit rating, and revising the outlook to positive from stable.
- The positive outlook reflects the potential for higher ratings on Avista if the acquisition is completed as proposed.

Rating Action

On July 19, 2017, S&P Global Ratings affirmed its ratings, including the 'BBB' issuer credit rating, on Avista Corp. and revised the outlook to positive from stable.

Rationale

The outlook revision on Avista reflects the potential for higher ratings upon the completion of the acquisition by Hydro One Ltd. (HOL). Post-acquisition, we will view Avista as a highly strategic subsidiary of HOL. Our assessment is based on our view that Avista will be an important member of the HOL group, highly unlikely to be sold, and integral to overall group strategy and operations. Avista will be a significant cash flow contributor to the group, making up about 22% of consolidated EBITDA. We would also see a strong, long-term commitment of support from HOL senior management in almost all circumstances.

Avista's highly strategic group status would result in an issuer credit rating one notch below the rating on HOL.

Our assessment of Avista's business risk reflects the strength and contribution of its regulated electric and gas utility operations. Avista conducts vertically integrated electric and natural gas distribution utility operations in Washington and Idaho, electric operations in Alaska, and gas distribution in Oregon. The company serves a total of about 700,000 customers.

Our financial risk profile assessment on Avista is based on financial ratio benchmarks that are more relaxed compared with those used for typical corporate issuers. This reflects the mostly steady cash flow from its regulated utility operations. Our base-case scenario projects adjusted funds from operations (FFO) to debt of roughly 16%-18% over the next two years.

Liquidity

We assess Avista's liquidity as adequate 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 in the event of a 10% decline in EBITDA. The assessment also reflects the company's generally prudent risk management, sound relationships with banks, and a generally satisfactory standing in credit markets.

Principal liquidity sources:
- Cash FFO of about $355 million; and
- Revolving credit facility availability of $400 million.

Principal liquidity uses:
- Debt maturities, including outstanding commercial paper, of about $110 million;
- Capital spending of about $410 million; and
- Dividends of about $95 million.

Outlook

The positive outlook reflects the potential for higher ratings on Avista if HOL completes its acquisition as proposed. Upon close of the transaction, we will consider Avista as a highly strategic subsidiary of HOL, resulting in an issuer credit rating on Avista that is one notch below our rating on HOL.

Downside scenario

We do not envision a lower rating on Avista, but we would revise the outlook to stable if the transaction fails to close or is completed in a manner that results in more than a one-notch downgrade of HOL.

Prior to the completion of the acquisition, we could lower the rating on Avista if its business risk weakens materially or credit measures diminish such that FFO to debt is consistently below 15%. This could occur due to increased use of leverage to cover funding shortfalls or adverse regulatory decisions leading to increased regulatory lag or a large deferral of costs.

Upside scenario

We could raise our ratings on Avista by one notch following the acquisition if our issuer credit rating on HOL is 'A-'. Once HOL owns Avista, we will base our issuer credit rating on Avista on the group's credit profile, which would typically be one notch lower.

We do not contemplate an upgrade on Avista before the acquisition is completed given the company's current business mix, regulatory risk, and financial measures in our base-case scenario.

Recovery Analysis/Issue Ratings

- 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.
- We rate the preferred stock issued by Avista Capital II two notches below the issuer credit rating on Avista Corp. to reflect the discretionary nature of the dividend and the deeply subordinated claim if a bankruptcy occurs.
- The short-term rating on Avista Corp. is 'A-2' based on our 'BBB' issuer credit rating on the company.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Positive/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

Related Criteria

- 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: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Avista Corp.		
Corporate Credit Rating	BBB/Positive/A-2	BBB/Stable/A-2

Ratings Affirmed

Avista Corp.	
Senior Secured	A-
Recovery Rating	1+
Avista Capital II	
Preferred Stock	BB+

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.