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## Research Update:

# DRAFT: Hydro One Ltd. And Hydro One Inc. Placed On Watch Negative, Avista Corp. On Watch Positive Ahead Of Regulatory Approvals

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**DRAFT**

## Research Update:

# DRAFT: Hydro One Ltd. And Hydro One Inc. Placed On Watch Negative, Avista Corp. On Watch Positive Ahead Of Regulatory Approvals

## Overview

- Toronto-based utility Hydro One Limited (HOL) has made significant progress in obtaining regulatory approvals on its pending acquisition of U.S.-based utility Avista Corp. (Avista), announced on July 19, 2017.
- This includes regulatory settlements in several states, including Washington, Idaho, Oregon, and Montana.
- As a result, we are placing our ratings on Hydro One Ltd. (HOL) and Hydro One Inc. (HOI) on CreditWatch with negative implications. This includes our 'A' issuer credit rating (ICR) on HOL and HOI, and our 'A' rating on HOI's senior unsecured debt.
- In addition, we are placing the 'A-1' global scale and 'A-1(Mid)' Canada scale commercial paper ratings of HOI on CreditWatch negative.
- At the same time, we are placing our ratings on Avista on CreditWatch with positive implications. This includes our 'BBB' ICR on the company and 'A-' rating on its senior secured debt.
- The CreditWatch negative listing on HOL and HOI reflects the likelihood of a one-notch ratings downgrade in the near term for both entities given the extent of the regulatory settlements thus far and the increasing expectation that the pending transaction with Avista will close.
- The CreditWatch positive listing on Avista reflects the increased potential for higher ratings on Avista when the transaction closes. This incorporates the higher ratings on HOL relative to Avista, and our expectation that Avista will be a highly strategic subsidiary of HOL post-acquisition.

## Rating Action

On June 15, 2018, S&P Global Ratings placed its 'A' issuer credit rating (ICR) on Toronto-based Hydro One Ltd. (HOL) and Hydro One Inc. (HOI) and the 'A' rating on HOI's senior unsecured debt on CreditWatch with negative implications.

In addition, we placed the 'A-1' global scale and 'A-1(Mid)' Canada scale commercial paper ratings on HOI on CreditWatch negative.

At the same time, we placed the 'BBB' issuer credit rating on Avista Corp. and

'A-' rating on its senior secured debt on CreditWatch with positive implications.

## **Rationale**

The CreditWatch negative listing on HOL and HOI reflects the increased potential for a one-notch ratings downgrade in the near term given the extent of the regulatory settlements thus far. We believe that these developments have increased the likelihood that the pending transaction with Avista will close as expected. Upon close of the transaction, we expect HOL's business risk to weaken modestly, reflecting a shift in business strategy that increases the company's operational and regulatory risks. Furthermore, we expect HOL's financial measures to weaken upon close of the transaction, including adjusted funds from operations (AFFO) to debt of about 10.0-10.5% for 2019-2020.

Based on the company's current financing plan, which includes about C\$1.4 billion of equity and C\$3.4 billion (US\$2.6 billion) of new debt, we expect a one-notch downgrade to our ICRs on HOL and HOI to 'A-'. We rate the senior unsecured debt at HOI the same as the issuer credit rating on HOI, because the debt is issued by a qualifying investment-grade utility.

The CreditWatch positive listing on Avista reflects the potential for higher ratings when the transaction closes. This incorporates our higher ratings on HOL relative to Avista, and our expectation that Avista will be a highly strategic subsidiary of HOL, post-acquisition. Upon close, our assessment reflects that Avista is highly unlikely to be sold, and will be integral to HOL's overall group strategy and operations. Avista will consist of about 20% of HOL's consolidated EBITDA.

## **CreditWatch**

We will resolve the CreditWatch placements on HOL, HOI, and Avista as we get closer to the closing of the transaction, including final regulatory approvals from key states, including Washington, Avista's largest regulatory jurisdiction.

### **Hydro One Ltd. (HOL)**

The CreditWatch negative listing on HOL and HOI reflects the increased potential for a one-notch ratings downgrade in the near term for both entities given the extent of the regulatory settlements thus far, and the likelihood that the pending transaction with Avista will close.

## **Avista Corp.**

The CreditWatch positive listing on Avista reflects the potential for higher ratings on Avista when the transaction closes. This incorporates the higher ratings on HOL relative to Avista, and our view that Avista will be a highly strategic subsidiary of HOL, post-acquisition.

## **Related Criteria**

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, 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

## **Related Research**

## **Ratings List**

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 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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