

Research Update:

# Avista Corp. 'BBB' Rating Affirmed On New Legislation In Washington State; Outlook Stable

May 20, 2019

## Rating Action Overview

- We expect passage of legislation in Washington state, which includes authority for the Washington Utilities and Transportation Commission (WUTC) to approve multiyear rate plans and allow recovery for certain utility investments deemed useful up to 48 months after rates have been approved, will be favorable for Avista Corp.'s business risk profile.
- At the same time, we expect Avista's financial measures to remain weak during our forecast period, reflecting funds from operations (FFO) to debt of 14%-16% throughout our forecast period.
- Taken together, we view the potential improvement in Avista's business risk as mitigating its otherwise modestly weaker financial measures. This supports revising our ratings downgrade threshold of FFO to debt to 14% from 15%.
- We are affirming all our ratings on Avista. The outlook is stable.
- The stable outlook reflects our expectation that the potential improvement to Avista's regulatory risk management strengthens its business risk profile, mitigating the company's modestly weaker financial measures, and for FFO to debt of 14%-16% throughout our forecast period.

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## Rating Action Rationale

Our rating action follows the recent passage of legislation in Washington state that we expect will improve Avista's regulatory risk management. This includes authority for the WUTC to approve multiyear rate plans and allow recovery for certain utility investments deemed useful up to 48 months after rates are approved.

Avista recently filed for a general rate increase under this construct. If approved, we expect this to reduce Avista's historical regulatory lag, strengthening our view of its business risk. As such, we revised our ratings downside threshold of FFO to debt to 14% from 15%. While we acknowledge the company's weaker financial measures for 2018 and 2019, our view of potential improvement in Avista's business risk mitigates its modestly weaker financial measures. Our base case assumes FFO to debt of 14%-16% over our forecast period.

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Our assessment of Avista's business risk profile primarily reflects its regulatory risk management, since about 95% of the company's overall EBITDA is derived from low-risk regulated utility operations. The company is generally authorized to use various cost recovery mechanisms to help alleviate regulatory lag but is somewhat exposed to potential excess power costs, typically tied to an earnings sharing mechanism in Washington.

We also incorporate our view of its regulatory diversity and generation mix. Avista primarily operates in Washington and Idaho; Oregon and Alaska jointly contribute less than 10% of its consolidated revenues. Moreover, its dependence on hydroelectric generation introduces fuel replacement risk during periods of unfavorable hydro conditions.

We assess Avista's financial risk profile under our medial volatility financial benchmark table, reflecting its business risk derived from its low-risk regulated utility operations and regulatory risk management. Under our base-case scenario--including capital spending averaging about \$400 million, dividends of about \$100 million, and a new multiyear rate case in Washington, and a merger termination payment to Avista from Hydro One, we expect FFO to debt of 14%-16% throughout our forecast period.

### Outlook

The stable outlook reflects our expectation that the potential improvement to Avista's regulatory risk management strengthens its business risk profile, mitigating the company's modestly weaker financial measures, and that we expect FFO to debt of 14%-16% throughout our forecast period.

### Downside scenario

We could lower our ratings on Avista during the next two years if adverse regulatory decisions weaken FFO to debt consistently below 14%, without sufficient countermeasures. We could also lower the ratings if Avista shifts its strategic focus to other business activities that weaken its credit quality.

### Upside scenario

We could raise our rating on Avista if it materially improves its financial measures such that FFO to debt is consistently above 20%.

### Company Description

Spokane, Wash.-based Avista is a vertically integrated regulated electric and natural gas utility company. It operates through two segments, Avista Utilities and Alaska Electric Light & Power Co. (AEL&P). Avista Utilities provides electric distribution and transmission, natural gas distribution services in parts of eastern Washington and northern Idaho, and natural gas distribution services in parts of northeastern and southwestern Oregon. AEL&P offers electric services to approximately 17,000 customers in the city and borough of Juneau, Alaska. Overall, Avista has about 382,000 electricity customers and approximately 347,000 natural gas customers.

## Liquidity

We assess Avista's liquidity as adequate. We expect sources to cover uses by more than 1.1x over the next 12 months even in the event of a 10% decline in EBITDA. Our assessment also reflects the company's generally prudent risk management, sound relationships with banks, and generally satisfactory standing in the credit markets.

Principal liquidity sources:

- Revolving credit facility of \$400 million;
- \$400 million cash FFO; and
- Minimal cash assumed.

Principal liquidity uses:

- Long-term debt maturities of about \$105 million in 2019;
- Assumed maintenance capital spending of \$245 million; and
- Dividends of approximately \$100 million.

## Issue Ratings - Subordination Risk Analysis

### Capital structure

Avista's consolidated capital structure comprises about \$1.8 billion of long-term debt, most of which is secured, and about \$50 million of preferred stock, issued through Avista Capital II.

### Analytical conclusions

We rate the preferred stock two notches below the issuer credit rating to reflect the deferability of the dividends, and because it is deeply subordinated to other instruments in the capital structure, consistent with our criteria. The short-term rating on Avista is 'A-2', based on our long-term issuer credit rating.

## Issue Ratings - Recovery Analysis

Avista's first-mortgage bonds benefit from a first-priority lien on substantially all of the utility's owned or subsequently acquired real property. Collateral coverage of more than 1.5x supports a recovery rating of '1+' and an 'A-' issue-level rating, two notches above the issuer credit rating.

## Ratings Score Snapshot

<b>Issuer Credit Rating</b>	BBB/Stable/A-2
<b>Business risk</b>	Strong
Country risk	Very low

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Industry risk	Very low
Competitive position	Satisfactory
<b>Financial risk</b>	Significant
Cash flow/Leverage	Significant
<b>Anchor</b>	bbb
<b>Modifiers</b>	
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)
<b>Stand-alone credit profile</b>	bbb

## Related Criteria

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- General Criteria: Methodology: Industry Risk, 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
- 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

## Ratings List

### Ratings Affirmed

#### Avista Corp.

Issuer Credit Rating BBB/Stable/A-2

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**Ratings Affirmed**

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**Avista Corp.**

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Senior Secured	A-
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Recovery Rating	1+
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**Avista Capital II**

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Preferred Stock	BB+
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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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