Exh. NAK-2
Docket UG-240008
Witness: Nicole A. Kivisto

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. CASCADE NATURAL GAS CORPORATION, Respondent.	DOCKET UG-240008

CASCADE NATURAL GAS CORPORATION

FIRST EXHIBIT TO THE
DIRECT TESTIMONY OF NICOLE A. KIVISTO

March 29, 2024

S&P Global
Ratings

Research

Research Update:

Cascade Natural Gas 'BBB+' Ratings Affirmed, Outlook Developing; SACP Revised Downward On Weaker Financial Measures

October 10, 2023

Rating Action Overview

- Cascade Natural Gas Corp.'s stand-alone financial measures have remained weak for its stand-alone credit profile (SACP), reflecting higher debt leverage because of an extended recovery of elevated natural gas costs. The company has also suffered from significant regulatory lag, with earned returns consistently lagging authorized levels for several years.
- In our view, Cascade remains a core subsidiary to parent MDU Resources Group Inc.
- As a result, we affirmed our ratings on Cascade, including our 'BBB+' issuer credit rating on the company and our 'BBB+' issue-level rating on its medium-term notes.
- We revised our SACP on Cascade downward to 'bb+' from 'bbb', reflecting our expectations that its stand-alone financial measures will remain consistently below previous levels.
- The developing rating outlook on Cascade is consistent with the outlook on parent MDU Resources and reflects the uncertainty regarding the parent's strategic review and capital structure plans. We expect Cascade's stand-alone funds from operations (FFO) to debt will reflect 10%-12% through 2024.

PRIMARY CREDIT ANALYST

William Hernandez
Dallas
+ 1 (214) 765-5877
william.hernandez
@spglobal.com

SECONDARY CONTACT

Gerrit W Jepsen, CFA
New York
+ 1 (212) 438 2529
gerrit.jepsen
@spglobal.com

Rating Action Rationale

Extended recovery of elevated natural gas costs has resulted in higher debt leverage. In early 2023, Cascade funded its elevated natural gas costs with proceeds from the issuance of a $150 million 364-day term loan, resulting in weaker stand-alone financial measures. We expect that it will likely take several years for it to fully recover these elevated costs from customers. We therefore expect the company's financial performance will remain consistently below our previous expectations, reflecting FFO to debt greater than 15%, despite the company earning a carrying charge on these higher costs. We now expect stand-alone FFO to debt of 10%-12% through 2024. As such, we revised Cascade's financial risk profile to aggressive from significant and its SACP to 'bb+' from 'bbb'.

The company's earned returns have consistently lagged authorized levels. Cascade's financial performance has suffered from weaker regulatory outcomes and significant regulatory lag. In August 2022, Cascade was authorized a $7.2 million rate increase by the Washington Utilities and Transportation Commission (WUTC) based on a 2020 year-end test period. This reflects about 20 months of regulatory lag. Before this, in May 2021, the WUTC ordered Cascade to reduce rates by about $400,000, determining that the company had failed to demonstrate the need for higher rates and negating the $7.4 million revenue increase sought initially. Weaker regulatory outcomes and consistent regulatory lag have resulted in financial performance that has lagged peers in the state, as demonstrated by stand-alone FFO to debt of about 12.5% for 2020-2022. Our revised base case incorporates FFO to debt of 10%-12% through 2024.

We continue to consider Cascade a core subsidiary of parent MDU Resources. Our assessment reflects our view that Cascade is highly unlikely to be sold, as it represents a significant portion of MDU Resources' utility segment (almost 25% of utility EBITDA). We also believe Cascade is integral to MDU Resources' overall group strategy of becoming a pure-play, regulated energy delivery company. Customer growth is also highest within Cascade's service territory compared to its affiliate peers. We therefore believe Cascade possesses a strong, long-term commitment from senior management, given its relative size and strategic importance to the group.

Outlook

The developing outlook on Cascade is consistent with the outlook on parent MDU Resources. This reflects the uncertainty regarding its strategic review and capital structure plans. We continue to consider Cascade as a core subsidiary of MDU Resources and expect that Cascade's stand-alone FFO to debt will reflect 10%-12% through 2024. We could affirm our ratings on Cascade and revise the outlook to stable over the next 18 months if we did the same for MDU Resources.

Downside scenario

We could lower the ratings on Cascade over the next 18 months by one or more notches if we lowered the ratings on MDU Resources or if we lowered our assessment of Cascade's group status.

Upside scenario

We could raise the ratings on Cascade over the next 18 months if we raised our ratings on MDU Resources.

Company Description

Cascade distributes natural gas to about 310,000 customers in western and central Washington and central and eastern Oregon. It is a subsidiary of MDU Resources Group Inc.

Our Base-Case Scenario

- Cascade files a multi-year rate plan in Washington during the first quarter of 2024.
- The company continues to recover investment costs annually related to its pipeline

replacement program.

- Capital spending averages $100 million per year through 2025.
- Cascade issues up to $100 million in senior unsecured notes in 2023 to refinance existing short-term debt, in line with recently submitted notices with its state commissions in Washington and Oregon.
- Dividends are used to balance Cascade's regulated capital structure.
- Negative discretionary cash flow indicates external funding needs.
- All debt maturities refinanced.

Liquidity

As of June 30, 2023, we assess Cascade's stand-alone liquidity as adequate, with sources covering uses by 1.1x over the next 12 months, even if forecast consolidated EBITDA declines 10%. We use slightly less stringent thresholds to assess Cascade's liquidity because we believe the constructive regulatory framework in Washington and Oregon provides a manageable level of cash flow stability even in times of economic stress.

Cascade maintains $100 million in committed credit facilities through 2027. We believe the company can lower its high capital spending during stressful periods, which limits the need to refinance under such conditions. Furthermore, our assessment reflects the company's sound relationships with its banks as evidenced by its sizeable banking group consisting of well-established and regional banks.

Overall, we believe the company will likely withstand adverse market circumstances during the next 12 months with sufficient liquidity to meet its obligations. We expect Cascade to refinance its $150 million term loan well in advance of its scheduled January 2024 maturity.

Principal liquidity sources:

- Cash and liquid investments of about $5 million.
- Credit facility availability of $100 million.
- Estimated cash FFO of about $75 million.
- Expected group support of $50 million.

Principal liquidity uses:

- Debt maturities of $150 million.
- Maintenance capital spending of about $40 million.
- Annual dividends of about $20 million.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of June 30, 2023, Cascade's capital structure comprises about $525 million of senior unsecured debt, including its $150 million term loan.

Analytical conclusions

We rate Cascade's senior unsecured debt obligations the same as our rating on the company because it is debt issued by a qualifying investment-grade utility.

Ratings Score Snapshot

Issuer credit rating: BBB+/Developing/--

Business risk: Strong

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Satisfactory

Financial risk: Aggressive

- Cash flow/leverage: Aggressive

Anchor: bb+

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: bb+

Group credit profile: bbb+

Entity status within group: Core

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014

- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed	
Cascade Natural Gas Corp.	
Issuer Credit Rating	BBB+/Developing/--
Cascade Natural Gas Corp.	
Senior Unsecured	BBB+

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.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.