Exh. NAK-3
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

SECOND EXHIBIT TO THE
DIRECT TESTIMONY OF NICOLE A. KIVISTO

March 29, 2024

S&P Global
Ratings

RatingsDirect®

Research Update:

MDU Resources Group Inc. And Cascade Natural Gas Downgraded To 'BBB', Outlooks Negative; Rating Actions On Other Subs

November 8, 2023

Rating Action Overview

- MDU Resources Group Inc. (MDU) completed its strategic review of its construction services business, MDU Construction Services Group Inc. (CSG), and will divest CSG through a spinoff to MDU shareholders by year-end 2024. This announcement follows the successful May 2023 spinoff of MDU's construction materials business Knife River Corp.
- We expect the separation of these higher-risk businesses to reduce MDU's consolidated business risk while weakening consolidated financial measures given the loss of operating cash flows. However, with the completed and pending divestitures, MDU's credit profile no longer benefits from the moderate diversification through owning multiple uncorrelated business lines.
- Accordingly, we lowered our issuer credit ratings on MDU and subsidiary Cascade Natural Gas Corp. by one notch to 'BBB' from 'BBB+'. The outlooks are negative. We lowered our issue-level rating on Cascade's senior unsecured debt to 'BBB' from 'BBB+'.
- We affirmed our ratings on Montana-Dakota Utilities Co. and on Centennial Energy Holdings Inc., and our short-term ratings on MDU, Montana-Dakota, and Centennial.
- We affirmed our 'A-2' commercial paper rating on Montana-Dakota. In addition, we withdrew our 'A-3' commercial paper rating on Centennial after MDU terminated the program.
- We revised our outlook on Montana-Dakota to negative from developing and revised our outlook on Centennial to positive from developing.
- The negative outlook on MDU, Cascade, and Montana-Dakota reflects the possibility of weaker consolidated financial measures from higher leverage following the separation of CSG. Our base case post divestiture reflects funds from operations (FFO) to debt consistently below 15%.
- Our positive outlook on Centennial reflects our expectation that the remaining Centennial businesses, after the CSG spin-off, will be core to MDU. Therefore, we would likely align the Centennial issuer credit rating with the rating on the MDU group.

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

Our downgrades of MDU and Cascade reflect the more limited diversification of the remaining businesses under MDU. We previously viewed MDU as a conglomerate operating multiple uncorrelated business lines that together provided moderate diversification benefits to MDU's credit profile. This benefit resulted in one notch of uplift to our issuer credit rating on the company. However, with the completed and pending separation of the CSG businesses, MDU will no longer benefit from moderate diversification of having multiple uncorrelated business lines, resulting in a one-notch lowering of our issuer credit ratings on MDU and Cascade.

Due to the presence of insulating measures at Montana-Dakota, we affirmed our issuer credit rating on the company. We view existing insulation at Montana-Dakota as sufficient to rate the company up to one notch above MDU's group credit profile. Montana-Dakota's stand-alone credit profile (SACP) is 'bbb+', supporting our 'BBB+' issuer credit rating.

For further information regarding the insulation measures, please see Montana-Dakota Utilities full analysis published June 22, 2023.

We assess MDU's business risk profile above the midpoint for its respective category. We expect MDU's lower-risk, rate-regulated utilities will contribute a significantly greater proportion to consolidated EBITDA (about 55%), following the spinoff of Knife River, and before the spinoff of CSG. Although we expect Centennial's remaining nonutility businesses of CSG (prior to spinoff) and WBI Holdings Inc. (natural gas transportation and storage) to contribute about 45% to consolidated EBITDA, we would assess MDU's business risk profile above the midpoint for its assessment of satisfactory relative to peers. We expect business risk will further strengthen after the spinoff of CSG by year-end 2024.

The loss of Knife River and CSG's cash flows weaken MDU's consolidated financial measures. Our base-case scenario assumes MDU successfully spins off CSG by year-end 2024, resulting in the loss of its cash flows starting in 2025. In addition, we expect regulated utility capital spending to remain elevated to accommodate volumetric growth predominantly in Cascade's service territory, Montana-Dakota's ongoing replacement of aging infrastructure, and WBI's ongoing expansion projects in the Bakken region. This incorporates a capital plan of between $500 million to $600 million annually through 2026.

Furthermore, in August, MDU realigned its dividend policy to a payout of 60%-70% of its regulated energy delivery earnings. In addition, we expect the disposal of its remaining shares in Knife River to provide over $300 million in cash proceeds (based on a $58 per share price assumption). Incorporating these assumptions, we forecast MDU's consolidated FFO to debt in the 14%-17% range for 2023-2025, compared with consolidated FFO to debt of 25% at year-end 2022. With the majority of MDU's cash flow now from utilities, we assess MDU's financial risk profile using our medial volatility benchmarks. These are more relaxed than the standard benchmarks we use for typical corporate issuers. This reflects MDR's lower-risk regulated utility operations and effective management of regulatory risk.

The repayment of over $1.1 billion in debt at Centennial strengthened its consolidated financial measures. Using proceeds from an $825 million one-time distribution from Knife River and new debt at MDU that the company intends to repay with the proceeds from the disposal of its remaining interest in Knife River, MDU repaid the entirety of Centennial's senior long-term debt, including about $455 million associated with Knife River and CSG, and about $645 million in outstanding term loans and borrowings under its revolving credit agreement. We forecast Centennial's stand-alone debt to EBITDA will improve to about 1.5x per year in 2023 and 2024 as compared to our prior expectations of 2x-2.5x over the same time period. Accordingly, we revised our assessment of Centennial's financial risk profile upward to intermediate from significant. After the spinoff of CSG (expected by year-end 2024), we expect Centennial's financial measures to weaken modestly following the cash flow loss.

We continue to incorporate a volatility adjustment at Centennial which reflects the potential for significant cash flow volatility at CSG during periods of stress. This volatility adjustment lowers its financial risk profile to intermediate from modest. The combination of a satisfactory business risk profile and intermediate financial risk profile, in addition to the strength of its consolidated financial measures within its respective financial risk profile category, raises Centennial's SACP to 'bbb-' from 'bb+'.

We revised upward our assessment of MDU's group support of Centennial. MDU's decision to spin off Centennial's higher-risk businesses is consistent with its stated strategy to focus on its core energy delivery businesses over the longer term. We believe this heightens the importance of Centennial's natural gas transportation and storage business under WBI, which we expect will contribute 100% of Centennial's EBITDA and 25% of MDU's consolidated EBITDA post-2024. Over 45% of WBI's revenues are generated through long-term transmission and storage contracts with affiliate Montana-Dakota; and given this relationship, we believe MDU will have a higher degree of support for Centennial. We therefore revised our group status on Centennial to strategically important from moderately strategic, reflecting our view that Centennial is unlikely to be sold, is important to the group's long-term strategy, has the long-term commitment of the group, and is a significant contributor to the MDU group.

Outlook-- MDU

The negative outlook on MDU reflects the possibility of weaker financial measures from higher leverage following the spinoff of CSG. Our base-case forecast incorporates MDU's consolidated FFO to debt in the 14%-17% range in 2023-2025.

Downside scenario

We could lower our ratings on MDU by one notch over the next 12 to 18 months if the company's financial measures reflect higher leverage following the spinoff of CSG, such that FFO to debt is consistently below 15%.

Upside scenario

We could revise the outlook to stable if MDU successfully spins off CSG, while maintaining FFO to debt consistently above 15%.

Outlook -- Cascade

The negative outlook on Cascade reflects the potential for a one-notch downgrade if we lower our ratings on parent MDU.

Downside scenario

We could lower our ratings on Cascade over the next 12 to 18 months if we lower our ratings on MDU.

Upside scenario

We could revise the outlook to stable if we revise the outlook on MDU to stable.

Outlook– Montana-Dakota Utilities

The negative outlook on Montana-Dakota reflects the potential for a one notch downgrade if we lower our ratings on parent MDU.

Downside scenario

We could lower our ratings on Montana-Dakota over the next 12 to 18 months if we lower our ratings on MDU, or if Montana-Dakota's stand-alone financial measures weaken such that its FFO to debt is consistently below 13%.

Upside scenario

We could revise the outlook to stable if we revise the outlook on MDU to stable, while Montana-Dakota maintains its stand-alone FFO to debt consistently above 13%.

Outlook-- Centennial

The positive outlook on Centennial reflects the potential for a one-notch upgrade if parent MDU maintains its credit quality consistent with current levels, following the spinoff of CSG, at which time we could align the ratings of Centennial with the group credit profile of MDU.

Downside scenario

We could affirm our ratings on Centennial and revise the outlook to stable if we lower our ratings on parent MDU by one notch.

Upside scenario

We could raise our ratings on Centennial if we affirm our ratings on MDU following the spinoff of CSG, at which time we would align the ratings on Centennial with the group credit profile of MDU.

Company Description

MDU is a holding company of businesses in three primary segments: regulated electric and natural gas utility distribution (55% EBITDA); engineering and construction (CSG; 30%); and natural gas pipelines (WBI; 15%). The company's utilities serve about 1,035,000 natural gas customers and 145,000 electric customers across eight states.

Our Base-Case Scenario

- MDU's regulated utilities benefit from ongoing cost recovery through authorized mechanisms and periodic rate case filings.
- The disposal of its remaining shares in Knife River generates between $300 million to $330 million in proceeds in 2023.
- Elevated capital spending between $500 million to $600 million per year through at least 2025.
- MDU maintains a dividend payout ratio between 60%-70%.
- Negative discretionary cash flow that indicates ongoing external funding needs.
- All debt maturities are refinanced.

Liquidity

MDU's short-term rating of 'A-2' is based on our issuer credit rating on the company. As of Sept. 30, 2023, we assess MDU's liquidity as adequate, with sources covering uses by 1.1x over the next 12 months, even if EBITDA declines 10%. We use slightly less stringent thresholds to assess MDU's liquidity because we believe its regulated utilities benefit from generally constructive regulatory frameworks that provide a manageable level of cash flow stability even in times of economic stress.

MDU maintains $750 million in committed credit facility capacity maturing beyond the next 12 months. 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 generally prudent risk management, sound relationships with its banks, and a satisfactory standing in the credit markets.

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 MDU to manage upcoming long-term debt maturities and refinance well in advance of scheduled due dates.

Principal liquidity sources

- Cash and liquid investments of about $32 million;
- Credit facility availability of $465 million;
- Estimated cash FFO of $430 million; and
- Sale proceeds (remaining Knife River shares) of $330 million.

Principal liquidity uses

- Debt maturities, including outstanding commercial paper, of about $368 million;
- Capital spending of roughly $575 million; and

- Dividends of about $130 million.

Ratings Score Snapshot

MDU Resources Group Inc.

BBB/Negative/A-2

Business risk: Satisfactory

- Country risk: Very low
- Industry risk: 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: Positive (+1 notch)

Stand-alone credit profile: bbb

- Group credit profile: bbb

Cascade Natural Gas Corp.

BBB/Negative/--

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

Montana-Dakota Utilities Co.

BBB+/Negative/A-2

Business risk: Excellent

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

Financial risk: Significant

- Cash flow/leverage: Significant

Anchor: a-

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: Negative (-1 notch)

Stand-alone credit profile: bbb+

- Group credit profile: bbb
- Entity status within group: Insulated

Centennial Energy Holdings Inc.

BBB-/Positive/A-3

Business risk: Fair

- Country risk: Very low
- Industry risk: Moderately High
- Competitive position: Fair

Financial risk: Intermediate

- Cash flow/leverage: Intermediate

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: Positive (+1 notch)

Stand-alone credit profile: bbb-

- Group credit profile: bbb
- Entity status within group: Strategically important (no impact)

Related Criteria

- Criteria | Corporates | Industrials: Key Credit Factors For The Midstream Energy Industry, Nov. 15, 2021
- 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
- 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
- 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

- 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

Downgraded; Outlook Action; Ratings Affirmed		
	To	**From**
MDU Resources Group Inc.		
Issuer Credit Rating	BBB/Negative/A-2	BBB+/Developing/A-2
Downgraded; Outlook Action		
	To	**From**
Cascade Natural Gas Corp.		
Issuer Credit Rating	BBB/Negative/--	BBB+/Developing/--
Ratings Affirmed; Outlook Action		
	To	**From**
Centennial Energy Holdings Inc.		
Issuer Credit Rating	BBB-/Positive/A-3	BBB-/Developing/A-3
Montana-Dakota Utilities Co.		
Issuer Credit Rating	BBB+/Negative/A-2	BBB+/Developing/A-2
Issue-Level Ratings Lowered		
	To	**From**
Cascade Natural Gas Corp.		
Senior Unsecured	BBB	BBB+
Issue-Level Ratings Affirmed		
Montana-Dakota Utilities Co.		
Commercial Paper	A-2	
Not Rated Action		
	To	**From**
Centennial Energy Holdings Inc.		
Commercial Paper	NR	A-3

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.