

## Research

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### Research Update:

# Cascade Natural Gas Corp. 'BBB+' Ratings Affirmed; Stand-Alone Credit Profile Revised To 'bbb'; Outlook Stable

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## Overview

- We expect U.S.-based Cascade Natural Gas Corp.'s financial measures to weaken to the lower end of the range for its financial risk profile category, reflecting the company's robust capital spending plan and U.S. corporate tax reform.
- We are affirming our ratings on Cascade, including our 'BBB+' issuer credit rating and 'BBB+' rating on its senior unsecured debt. The outlook remains stable.
- At the same time, we are revising Cascade's stand-alone credit profile (SACP) to 'bbb' from 'bbb+' and our comparable ratings analysis modifier to neutral from positive.
- Our ratings and stable outlook reflect Cascade's core relationship to parent MDU Resources and our expectation that management will continue to focus on its core utility operations and reach constructive regulatory outcomes to avoid any meaningful rise in business risk. The outlook also reflects our base-case forecast for Cascade's adjusted funds from operations (FFO) to debt of about 13%-16%, in line with the lower end of the range for its financial risk profile category.

## Rating Action

On Sept. 27, 2018, S&P Global Ratings affirmed its 'BBB+' issuer credit rating on Cascade Natural Gas Corp. The outlook is stable. We also affirmed the 'BBB+' issue-level rating on the company's senior unsecured debt.

## Rationale

The affirmation of our 'BBB+' issuer credit rating reflects our assessment that Cascade is a core subsidiary of ultimate parent MDU Resources Group Inc. This reflects our opinion that Cascade is integral to MDU's future strategy, MDU is highly unlikely to sell Cascade, and Cascade has a strong long-term commitment from MDU's senior management team.

Our revised assessment of Cascade's SACP reflects our expectations of sustained weaker financial measures, reflecting the lower end of the range for the company's financial risk profile, including adjusted FFO to debt of about

13%-16%. This largely reflects the company's increased capital spending plan and the adverse cash flow effects from tax reform.

Cascade's SACP reflects our assessment of the company's business risk profile as strong and its financial risk profile as significant.

Our assessment of Cascade's business risk reflects its low-risk regulated gas distribution operations, smaller than average customer base of about 285,000, service territory per capita income weaker than the national average, and effective management of regulatory risk.

The company recently received an order on its general rate case in Washington state for a permanent rate reduction of \$2.9 million, incorporating tax reform. Although this reduction will decrease cash flows, Cascade benefits from other constructive regulatory mechanisms such as decoupling, purchased gas adjustments, and a pipeline replacement mechanism that provide cash flow stability. Furthermore, the company is in the middle of a general rate case in Oregon, filed a pipeline safety cost recovery mechanism there, and filed its annual pipeline cost recovery mechanism in Washington. Successful outcomes in these proceedings would support the company's credit quality. Overall, we assess the company's business risk profile at the higher end of the range compared to peers.

We assess Cascade's financial measures using our medial volatility table to reflect its lower-risk regulated utility operations and effective management of regulatory risk. Our base-case assumptions include modest customer growth of 1%-2%, tax reform, capital spending to average about \$100 million annually over the next three years, the company's recent rate case outcome, continued use of regulatory mechanisms, future rate case increases, modest operations and maintenance expense growth, and equity infusions by MDU to maintain the regulatory capital structure. As such, we expect financial measures to reflect the lower end of the range for the financial risk profile category. Specifically, we expect FFO to debt to average about 13%-16%.

### **Group influence**

In our opinion, the cumulative value provided by structural and regulatory protections--including dividend restrictions, maintenance of an investment-grade rating, a nonconsolidation opinion, regulatory approval for capital structure changes, and an independent director--could insulate Cascade's credit quality from MDU and provide sufficient basis to potentially differentiate our issuer credit rating on the subsidiary.

Despite this assessment of sufficient insulation at Cascade to potentially differentiate our ratings on Cascade from those of its parent, we do not differentiate our issuer credit rating on Cascade from our rating on MDU because our assessment of Cascade's SACP as 'bbb' is lower than our assessment of MDU's group credit profile. However, because we assess Cascade as a core entity to MDU, the issuer credit rating is in line with that on MDU.

## **Liquidity**

We assess Cascade's liquidity as adequate to cover its needs over the next 12 months. We expect the company's liquidity sources to exceed uses by more than 1.1x. Cascade's liquidity benefits from stable cash flow generation, ample availability under the revolving credit facilities, and manageable debt maturities over the next few years. The company's well-established and solid bank relationships, prudent risk management, ability to absorb high-impact, low-probability events with limited need for refinancing, and satisfactory standing in credit markets also support our assessment.

Principal liquidity sources:

- Minimal cash outstanding;
- Credit facility availability of about \$70 million; and
- FFO of about \$45 million.

Principal liquidity uses:

- Maintenance capital spending of about \$90 million; and
- Distributions to the parent of about \$15 million.

## **Outlook**

Our stable outlook reflects Cascade's core relationship to MDU Resources as well as our expectation that management will continue to focus on its core utility operations and reach constructive regulatory outcomes to avoid any meaningful rise in business risk. The outlook also reflects our base-case forecast of adjusted FFO to debt of about 13%-16%, in line with the lower end of the range for its financial risk profile category.

## **Downside scenario**

We could lower ratings on Cascade if we downgrade MDU. This could happen if the relative proportion of its regulated utilities and pipelines businesses decrease to below 50% of consolidated MDU or if MDU's consolidated financial measures weaken to the lower end of the range for its significant financial risk profile category.

## **Upside scenario**

We could raise our ratings on Cascade if we upgrade MDU Resources. This could occur if MDU's FFO to debt consistently improves to above 23% and it maintains the proportion of its regulated utilities and pipelines businesses at more than 50% of consolidated MDU. That could follow if MDU further improves the gross margins at its regulated businesses through better rate case outcomes and simultaneously has higher-than-expected growth at its construction materials business while the regulated utilities and pipelines businesses remain greater than 50% of the company.

## Ratings Score Snapshot

Issuer Credit Rating: BBB+/Stable/--

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)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb

- Group credit profile: bbb+
- Entity status within group: Core (+1 notch from the SACP)

## Issue Ratings--Subordination Risk Analysis

We rate Cascade's senior unsecured debt obligations the same as the issuer credit rating because Cascade is a qualifying investment-grade utility as per our criteria.

## 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
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014

- Criteria - Corporates - Industrials: Key Credit Factors For The Midstream Energy Industry, Dec. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Building Materials Industry, Dec. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Engineering And Construction Industry, Nov. 19, 2013
- General Criteria: Group Rating Methodology, 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 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

## Ratings List

### Ratings Affirmed

Cascade Natural Gas Corp.  
Issuer Credit Rating

BBB+/Stable/--

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.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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