

## Research

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### Research Update:

# Cascade Natural Gas Corp. 'BBB+' Rating Affirmed; Outlook Stable

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## Research Update:

# Cascade Natural Gas Corp. 'BBB+' Rating Affirmed; Outlook Stable

## Overview

- U.S. regulated utility Cascade Natural Gas Corp. has demonstrated a gradual improvement in managing regulatory risk, which offsets marginally weakening financial measures.
- We are affirming our 'BBB+' issuer credit rating on Cascade Natural Gas Corp. The outlook is stable.
- Cascade Natural Gas recently received a \$4 million rate case increase based on a settlement agreement that included revenue decoupling.
- In our view, this outcome indicates a gradual improvement in management of regulatory risk and we consequently assess Cascade's business risk profile at the higher half of the strong business risk profile category.
- We revised our assessment of the comparable rating analysis modifier to negative from neutral, reflecting our expectations for a modest weakening of financial measures that will more consistently reflect the lower end of the intermediate financial risk profile category.
- The stable outlook reflects our expectation that management will continue to reach constructive regulatory outcomes, avoiding any meaningful rise in business risk and that funds from operations (FFO) to debt will approximate 26%.

## Rating Action

On Sept. 20, 2016, S&P Global Ratings affirmed its 'BBB+' issuer credit rating on Cascade Natural Gas Corp. The outlook is stable. We also affirmed the 'BBB+' rating on the senior unsecured debt.

## Rationale

Our issuer credit rating on Cascade is based on our assessments of its strong business risk profile and intermediate financial risk profile.

The strong business risk profile reflects the company's lower-risk regulated utility that has generally supportive regulation in Oregon and Washington and a primarily residential and commercial customer base that supports cash flow stability. Offsetting this is the company's small customer base in its lightly populated two-state service territory and per capita income in its service territories that is weaker than the national average.

Recently the company received a rate case order that increases revenue by about \$4 million, consistent with the settlement, which also allows the

company to implement a decoupling mechanism that we expect will allow the company to more consistently earn closer to its allowed return on equity. This outcome is consistent with our view of a gradual improvement in regulatory risk management. Correspondingly, we assess Cascade's business risk profile at the higher half of the strong business risk profile category

We assess the financial measures based on the medial volatility financial ratio benchmarks, reflecting the company's low-risk regulated gas distribution utility and its effective management of regulatory risk that is generally consistent with peers. We expect that the financial measures will be consistent with the lower end of the intermediate financial risk profile category. Under our base-case scenario that incorporates ongoing capital spending and steady cost recovery through various rate mechanisms, such as decoupling, and rate case increases in Oregon and Washington, we expect FFO to debt of about 26% consistent with the lower end of the intermediate financial risk profile category.

The determination of our initial assessment of an 'a-' given the two potential outcomes ('a-' or 'bbb+') for the combination of a strong business risk profile and intermediate financial risk profile, reflects our assessment of Cascade's business risk toward the upper end of the strong business risk profile category relative to its comparably rated peers. Our initial assessment is lowered one notch, incorporating our assessment of the negative comparable rating analysis (CRA) modifier, reflecting our expectations that the financial measures will consistently reflect the lower end of the intermediate financial risk profile category. The stand-alone credit profile (SACP) and issuer credit rating are 'BBB+'.

## **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 its 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, the ability to absorb high-impact, low-probability events without the need for refinancing, and a satisfactory standing in credit markets also support our assessment of its liquidity as adequate.

## **Outlook**

Our stable rating outlook reflects 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 level of adjusted FFO to debt of about 26%, in line with the lower end of the range for the intermediate financial risk profile category.

### Downside scenario

We could lower ratings on Cascade if we downgrade parent MDU Resources or if Cascade's financial risk profile weakens significantly due to prolonged deterioration in financial measures including FFO to debt below 23%. We could also lower ratings if, in our opinion, there is material degradation in the current insulation measures and we lower ratings on parent MDU.

### Upside scenario

Higher ratings are contingent on either an upgrade on ultimate parent MDU Resources or a higher stand-alone credit profile on Cascade. Cascade's stand-alone credit profile could improve if its financial measures strengthened and consistently exceeded our base-case forecast, including adjusted FFO to total debt consistently in the middle of the range for the intermediate financial risk profile category, or FFO to debt of 27%-31%.

## Group Rating Methodology

Under our group rating methodology, we assess Cascade as a core entity to MDU Resources Group Inc. since it is unlikely to be sold in the near term; it operates in lines of business or functions integral to the overall group strategy; it has strong, long-term commitments of support from senior group management in good times and under stressful conditions; is closely linked to MDU's reputation because of its regulated nature; has been operating more than 60 years; and it is likely to receive support from the group should it fall into financial difficulty. In addition, Cascade's business is similar to those of MDU's principal utility operations, which will continue to be a large portion of the consolidated group.

In our opinion, the cumulative value provided by structural and regulatory protections, including dividend restrictions, maintaining an investment grade rating, a nonconsolidation opinion, regulatory approval for capital structure changes, and an independent director, could insulate the credit quality of Cascade from parent MDU and could provide S&P Global Ratings with sufficient basis to potentially differentiate our issuer credit rating on the subsidiary.

Our 'bbb+' SACP and 'BBB+' ICR on Cascade are consistent with the 'bbb+' group credit profile for parent MDU Resources Group Inc.

## Ratings Score Snapshot

Corporate Credit Rating: BBB+/Stable/--

Business risk: Strong

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

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: a-

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: Negative (-1 notch)

Stand-alone credit profile: bbb+

Group rating methodology: Core (no impact)

## Related Criteria And Research

### Related Criteria

- 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
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 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 - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Ratings List

Ratings Affirmed

Cascade Natural Gas Corp.  
Corporate Credit Rating

BBB+/Stable/--

Cascade Natural Gas Corp.

Senior Unsecured

AA-

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.globalcreditportal.com](http://www.globalcreditportal.com) and at [www.spcapitaliq.com](http://www.spcapitaliq.com). All ratings affected by this rating action can be found on the 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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