

# Global Credit Portal

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### Summary:

## PacifiCorp

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# PacifiCorp

**Credit Rating:** A-/Stable/A-2

## Rationale

The 'A-' corporate credit rating (CCR) on PacifiCorp reflects its "excellent" business risk profile, which is based on a diverse and growing service territory, and a "significant" financial risk profile that reflects a large capital program and the need to shore up cash flow metrics. PacifiCorp is owned by MidAmerican Energy Holdings Co. (MEHC; BBB+/Stable/--). In turn, MEHC is privately held and majority owned by Berkshire Hathaway Inc. (AA+/Stable/A-1+). As of Sept. 30, 2009, Berkshire owned 89.5% of the voting common stock in MEHC, with the balance owned by an MEHC board member and the company's president and CEO, who also sits on the board. MEHC had approximately \$19.5 billion of debt, and the utility had \$6.4 billion long-term debt. Consolidated long-term debt at MEHC (which includes PacifiCorp's debt) was nearly \$19.5 billion as of the same date.

MEHC's credit profile is supported by Berkshire, which has in place through February 2011 a \$3.5 billion equity commitment agreement with MEHC by which MEHC can unilaterally call upon Berkshire to support either its debt repayment or the capital needs of its regulated subsidiaries, including PacifiCorp. Berkshire's liquidity position and financial flexibility remain very strong, in our view, despite its Feb. 4 one-notch downgrade to 'AA+' from 'AAA'. We view this agreement between PacifiCorp's parent and a 'AA+' rated entity as reducing the likelihood of a PacifiCorp default. Nevertheless, we expect the utility to have a stand-alone credit profile consistent with our 'A-' rating. We take this view because the utility cannot cause MEHC to make an equity contribution, either from MEHC or via Berkshire through an MEHC board request. Although MEHC would typically have strong incentives to support the utility by tapping the Berkshire contingent equity, we note that in a catastrophic utility event, we would expect MEHC to call on Berkshire for equity support only if doing so were in MEHC's economic interests.

PacifiCorp serves 1.7 million customers in portions of six Western states: Oregon, Washington, and California, where it operates as Pacific Power; and Utah, Wyoming, and Idaho, where it operates as Rocky Mountain Power. The company's two largest markets, Utah and Oregon, accounted for about 68% of the company's retail electric sales in 2008, with Wyoming and Washington at 24%, and Idaho and California the balance. Although the ring-fenced utility's credit metrics are more consistent on a stand-alone basis with the 'BBB' rating category, Standard & Poor's Ratings Services expects that management will achieve cash flow metrics more consistent with the 'A' rating category over the next several years. Supportive rate case outcomes remain key to maintaining and improving financial performance. When MEHC purchased PacifiCorp in 2006 from ScottishPower, the utility had consistently been unable to earn its authorized return on equity (ROE), which varies by jurisdiction but ranges from 10% to 10.6%. Management has focused on improving its returns, with some success. In 2008, our calculations suggest that the consolidated ROE for PacifiCorp was 8.3%. Regulatory lag remains an issue for the company, although state regulation permits the company to use forward test years for rate cases in Utah, Oregon, Wyoming, and California. (Idaho and Washington require historical test years.)

PacifiCorp has power and fuel cost adjusters in Idaho, Wyoming, and California that allow for the deferral of these costs for later collection. In Oregon, fuel and purchased power costs are updated in rates every January based on

forecast power prices, but there is no true-up to reconcile these projected costs with actuals. In March 2009, PacifiCorp filed for an energy cost adjustment mechanism in Utah. The Utah commission ruled that the clause is in the public interest, and the structure of the mechanism is currently under consideration.

The company expects to spend \$6.1 billion in 2009-2011, excluding non-cash allowance for funds used during construction, and capital expenditures for the first nine months of 2009 totaled \$1.8 billion. The largest component of PacifiCorp's capital program is the construction of the Gateway transmission project, an estimated \$6.1 billion, 2,000-mile transmission line connecting portions of Wyoming, Utah, Idaho, Oregon, and the southwestern U.S. The project is being completed in phases, with initial portions of new lines going into service as early as 2010 and completion scheduled for 2018. About 23% of the company's total capital budget over the next three years is devoted to transmission investment, of which Gateway is a component. In 2008, the Federal Energy Regulatory Commission awarded the company incentive rate treatment of 200 basis points for seven of the eight project segments.

Operating income has improved relative to 2008 due in large part to lower fuel costs and regulatory rate relief, which also resulted in higher gross margins per megawatt-hour sold for the 12 months ended Sept. 30, 2009. In that period, cash flow from operations received a boost from increased net income and the changes in regulatory assets and liabilities, as compared with year-end 2008. Approximately 30%-32% of PacifiCorp's total electric sales are to industrial customers. The company experienced an approximate 4% decline in retail sales for the first nine months of 2009.

Leverage as of Sept. 30, 2009, was 53.5%, up from 52.6% as of year-end 2008 and reflected approximately \$863 million of new long-term borrowing in the first nine months of 2009, net of maturities. Equity investments from MEHC will remain key to maintaining balanced structure throughout the company's capital program. Debt to total capitalization reflects several adjustments we make, the largest of which include adding \$424 million for power purchase obligations and \$379 million for post-retirement obligations. We expect that PacifiCorp will not be in a position to make distributions to its parent while it executes its capital program, and that PacifiCorp's debt leverage will approach the 50% area in the next several years.

Cash flow metrics remain weak for the rating but are improving modestly. For the 12 months ended Sept. 30, 2009, funds from operations (FFO) to total debt was nearly 19% and FFO interest coverage was 4.3x, which are consistent with 2008 ratios. We would expect PacifiCorp to produce FFO interest coverage in the range of 4.0x-4.5x and FFO to total debt in the 20% area.

### **Short-term credit factors**

The company's liquidity is strong. The 'A-2' short-term rating reflects our view that although a \$3.5 billion contingent equity agreement between MEHC and Berkshire supports MEHC and its subsidiaries, the agreement is not a source of instantaneous liquidity. The agreement allows Berkshire up to 180 days to fund MEHC's request. Given the recent turmoil in both liquidity and the capital markets, we have taken a firmer view on the need to link the short-term ratings on PacifiCorp to its stand-alone credit quality, which supports an 'A-2' short-term rating. However, we note that although Berkshire contractually has up to six months to respond to an MEHC call for liquidity, it has strong economic incentives to do so.

PacifiCorp's cash and cash equivalents totaled \$149 million as of Sept. 30, 2009. In addition, the company has \$1.4 billion in unsecured revolving credit structured in two separate agreements: a \$760 million line expiring July 2013

and a \$635 million line extending through October 2012. As of Sept. 30, 2009, the company had no balances under the credit facilities and had letters of credit in place for \$258 million, leaving \$1.14 billion available under its revolving credit facilities. PacifiCorp's single largest exposure to any banks under its revolving facility as a percentage of total commitments is 15%, which is manageable. Regulators limit PacifiCorp to \$1.5 billion in debt.

## Outlook

The stable outlook for PacifiCorp incorporates our expectation that MEHC will continue to support the utility by contributing sufficient equity to ensure that the utility keeps fully adjusted debt to total capitalization over the next few years close to an adjusted 50%, and that FFO to total debt and FFO interest coverage will be 20% or better and in the range of 4.0x-4.5x, respectively. Given that PacifiCorp's financial risk profile is weak for the current ratings, we do not expect near-term upward ratings momentum. PacifiCorp's ring-fenced structure insulates it from some MEHC credit deterioration. Specifically, our criteria provide that the PacifiCorp CCR can be no more than three notches above the MEHC CCR. The company is comfortably within this range, so we see no significant prospects for the utility rating to fall as a result of adverse rating changes at MEHC, which also has a stable outlook. Upward ratings momentum is unlikely, given the need to improve credit ratios, which may be difficult to achieve due to the size of the company's capital program.

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