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Research Update:

Berkshire Hathaway Energy Co. And Subs Ratings Raised To 'A' On New View Of Relationship To Parent; Outlook Stable

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Research Update:

Berkshire Hathaway Energy Co. And Subs Ratings Raised To 'A' On New View Of Relationship To Parent; Outlook Stable

Overview

- We have reassessed our view of Berkshire Hathaway Energy Co.'s (BHE) relationship with its parent company Berkshire Hathaway Inc. The reassessment reflects BHE's strategic importance and contributions to its parent.
- We are raising our issuer credit rating on BHE to 'A' from 'BBB+'. We are also raising our issuer credit ratings on BHE's U.S.-based utility subsidiaries to 'A'.
- At the same time, we are raising our rating on BHE's senior unsecured debt to 'A-' from 'BBB+'. We are also raising the short-term issuer credit and commercial paper ratings for BHE and its U.S.-based utilities to 'A-1' from 'A-2'.
- We are assigning an 'A' issuer credit rating to BHE-owned intermediate holding company MidAmerican Funding LLC.
- The outlook is stable.

Rating Action

On Feb. 19, 2016, Standard & Poor's Ratings Services raised its issuer credit rating (ICR) on Berkshire Hathaway Energy Co. (BHE) to 'A' from 'BBB+'. We raised the rating on BHE's senior unsecured debt to 'A-' from 'BBB+' and the short-term rating on BHE and its U.S.-based utility subsidiaries to 'A-1' from 'A-2'.

We also raised the ICRs on BHE's subsidiaries PacifiCorp and MidAmerican Energy Co. to 'A' from 'A-', and the ICRs on BHE's subsidiaries Nevada Power Co. and Sierra Pacific Power Co., and intermediate holding company NV Energy Inc. to 'A' from 'BBB+'.

In addition, we assigned our 'A' ICR to BHE-owned intermediate holding company MidAmerican Funding LLC.

The outlook is stable for all companies.

Rationale

The upgrades follow our reassessment of the linkage between parent Berkshire Hathaway Inc. and its subsidiary BHE. The reassessment reflects BHE's strategic importance and contributions to consolidated Berkshire Hathaway (this is a change from our previous view of moderately strategic; see the research update on Berkshire Hathaway published Feb. 19, 2016), incorporating our view of BHE's growing importance to the group's consolidated earnings. As a result, BHE's ICR is now two notches closer to its parent. Our view of BHE's own credit profile is unchanged. The relationship between BHE and its U.S.-based utilities and intermediate holding companies are unchanged, and therefore we assign the same ICR as BHE to each subsidiary.

We are raising BHE's unsecured debt rating only one notch to better reflect its subordinated position in the capital structure. We view recovery prospects at the holding company as marginally weaker than those at its subsidiaries. Priority liabilities at the subsidiaries have accumulated such that they now overcome the diversity benefits that we previously relied on to equate the rating with the ICR.

Our excellent business risk assessment of BHE incorporates our view of the company's strong competitive position and very low country risk with operations in the U.S., the U.K., and Canada. In addition, the very low industry risk determination for BHE stems from the regulated utility industry that provides indispensable and strategically important services to regional economies, have material barriers to entry, and essentially operate as a monopoly insulated from market challenges. BHE's strong competitive position reflects substantial geographical and operational diversity from numerous utilities. The customer base is roughly divided among residential, commercial, and industrial customers, which provide customer diversity and a base level of usage. The utilities have efficient electricity generating operations that produce competitively priced power, high levels of plant usage, few unforced outages, and high reliability. In addition, utility subsidiaries operate under regulatory terms that largely support credit quality and are generally constructive, which include good fuel clause mechanisms and other cost pass-through mechanisms. BHE's nonutility operations will likely continue to contribute about 20% of consolidated EBIDTA, and our base case reflects our view that these operations will not reach a level that would result in a business risk profile change.

The financial risk profile is significant based on our medial volatility financial ratio benchmarks. This takes into consideration our expectation that financial measures will remain roughly at current levels after taking into account the company's capital spending and limited owner distributions. Parent Berkshire Hathaway does not rely on BHE to make distributions, bolstering BHE's equity capital through retained earnings and helping to support its balance sheet, even as BHE makes acquisitions and capital investments. Our baseline forecast over the next three years includes adjusted funds from operations (FFO) to debt ranging from 14% to 16%, below the midpoint of the significant category. Over the same period, our supplemental ratio of operating cash flow to debt ranges from 15% to 17%, above the midpoint of the significant category. Total adjusted debt to EBITDA ranges from about 6.3x to about 5.5x, trending toward the aggressive financial risk profile benchmark range. Discretionary cash flow, which is strengthened due to limited dividends, continues to remain robust, providing capital for various purposes, including investments and acquisitions.

Liquidity

BHE has adequate liquidity. We believe the company's liquidity sources are likely to cover its uses by more than 1.1x over the next 12 months and to meet cash outflows, even with a 10% decline in EBITDA. The adequate assessment also reflects the company's generally prudent risk management, sound relationships with banks, and a generally satisfactory standing in credit markets.

Principal liquidity sources:
- Assumed cash and liquid investments of roughly $620 million,
- Estimated FFO of about $6 billion, and
- Revolving credit facility availability of $6.7 billion.

Principal liquidity uses:
- Capital spending of roughly $6.5 billion, and
- Debt maturities of about $2.2 billion, including short-term debt issuances.

Other Credit Considerations

The ratings on BHE reflect a negative adjustment for the influence of higher-risk nonutility businesses that include renewable power generation, pipelines, and real estate brokerage. They currently account for roughly 20% of consolidated EBIDTA. Core financial ratios that indicate a financial risk profile falling to the weaker end of the category also contribute to the adjustment.

In addition, we further adjust downward due to BHE's financial policy to reflect our view of ongoing event risk related to acquisitions and investments.

Group Influence

Standard & Poor's bases its ratings on BHE on the consolidated group credit profile and application of our group ratings methodology. Reflecting our view of BHE's growing importance to Berkshire Hathaway's consolidated earnings, we deem BHE to be a strategically important subsidiary of Berkshire Hathaway. BHE is important to Berkshire Hathaway's long-term strategy, is unlikely to be sold, and we expect that Berkshire Hathaway will continue to support BHE. As a result, our ICR for BHE incorporates a three-notch uplift from its 'bbb' SACP.

Outlook

Our stable rating outlook on BHE reflects our expectation that its relationship to its parent does not change and that management will continue to focus on its core utility operations and reach constructive regulatory outcomes that support the existing business risk. Although BHE has used significant debt leverage for acquisitions and capital investments, we expect credit measures to strengthen to support the current rating. Under our base-case forecast, we expect adjusted FFO to debt to range from 15% to 16% over the next few years.

Downside scenario

We could lower ratings if core financial measures continuously underperform our base-case forecast and remain consistently at less credit-supportive levels, including adjusted FFO to total debt of less than 13%. This could occur if rate case outcomes are consistently weaker than expected, regulatory lag increases, or if capital spending grows and is largely debt-financed. Acquisition risk remains a consideration and could lead to a ratings change depending on the target entity, the financial risk profile when the acquisition is announced, and the transaction's financing.

Upside scenario

Given our assessment of business risk and expectations of financial performance, we do not expect higher ratings over the next few years. However, we could raise the ratings if the company's business risk profile strengthens, including if regulated utility operations materially increase as a percentage of total operations. We could raise the ratings if financial measures strengthen and consistently exceed our base-case forecast, including adjusted FFO to total debt approaching 23%, the high end of the significant financial risk profile category. Stronger financial measures could occur for various reasons, including through higher operating cash flow due to economic growth in the utilities' service territories, debt reduction with free operating cash flow, or greater equity funding of investments.

Ratings Score Snapshot

Corporate credit rating: A/Stable/A-1

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: Negative (-1 notch)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: 'bbb'
- Group credit profile: 'aa'
- Entity status within group: Strategically important (+3 notches from SACP)

Issue Ratings

We rate the senior unsecured debt at BHE one notch lower than the ICR because priority liabilities, including operating utility debt, significantly exceed 20% of total assets. The short-term rating is 'A-1' based on the company's ICR and our assessment of its liquidity as adequate.

Related Criteria And Research

Related Criteria

- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2016
- Corporate Methodology, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- Utilities: Notching Of U.S. Investment-Grade Investor-Owned Utility Unsecured Debt Now Better Reflects Anticipated Absolute Recovery, Nov. 10, 2008
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related research

- Berkshire Hathaway Inc. Removed From CreditWatch Negative, Ratings Affirmed; Outlook Stable, Feb. 19, 2016

Ratings List

Ratings Raised

	To	From
Berkshire Hathaway Energy Co.		
Corporate Credit Rating	A/Stable/A-1	BBB+/Stable/A-2
Senior Unsecured	A-	BBB+
Commercial Paper	A-1	A-2
MidAmerican Energy Co.		
Corporate Credit Rating	A/Stable/A-1	A-/Stable/A-2
Senior Secured	A+	A

Recovery rating	1+	1+
Commercial Paper	A-1	A-2
NV Energy Inc.		
Corporate Credit Rating	A/Stable/--	BBB+/Stable/--
Senior Unsecured	A-	BBB
Sierra Pacific Power Co.		
Corporate Credit Rating	A/Stable/--	BBB+/Stable/--
Senior Secured	A+	A
Recovery rating	1+	1+
Nevada Power Co.		
Corporate Credit Rating	A/Stable/--	BBB+/Stable/--
Senior Secured	A+	A
Recovery rating	1+	1+
PacifiCorp		
Corporate Credit Rating	A/Stable/A-1	A-/Stable/A-2
Senior Secured	A+	A
Recovery rating	1+	1+
Preferred Stock	BBB+	BBB
Commercial Paper	A-1	A-2
Corp. Credit Rating Assigned; Debt Rating Raised		
MidAmerican Funding LLC		
Corporate credit rating	A/Stable/--	
	To	From
Senior Secured	A-	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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.