S&P Global Ratings

RatingsDirect®

Alectra Inc.

Primary Credit Analyst:
Mayur Deval, Toronto (1) 416-507-3271; mayur.deval@spglobal.com

Secondary Contact:
Andrew Ng, Toronto + 1 (416) 507 2545; andrew.ng@spglobal.com

Table Of Contents

Credit Highlights

Outlook

Our Base-Case Scenario

Company Description

Business Risk

Financial Risk

Liquidity

Environmental, Social, And Governance

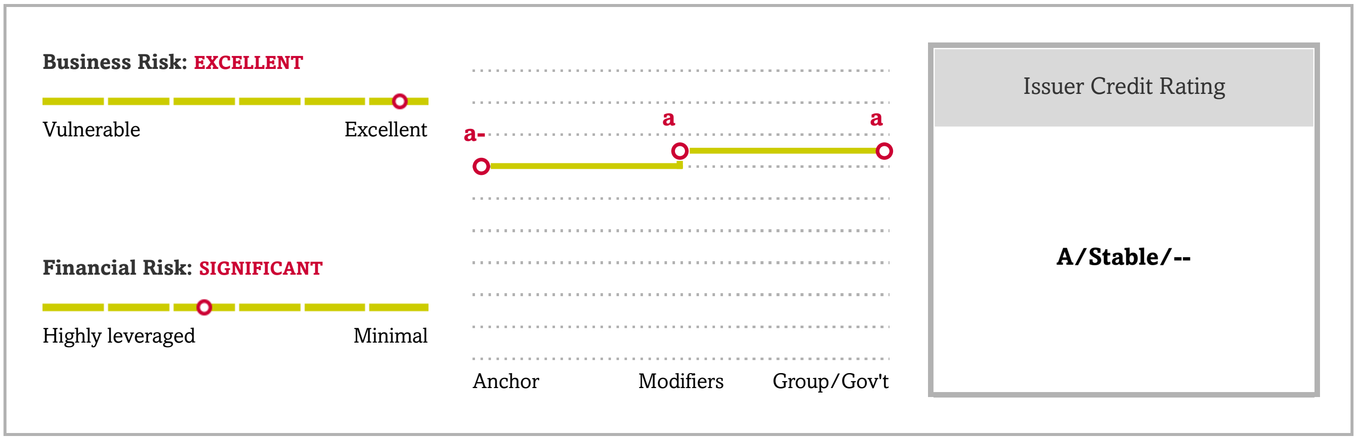
Government Influence

Issue Ratings - Subordination Risk Analysis

Ratings Score Snapshot

Related Criteria

Alectra Inc.



Credit Highlights

Overview

Key Strengths	Key Risks
Majority of cash flows from low-risk regulated electricity distribution operations.	Deferral of COVID-19 costs recovery could weaken financial measures modestly.
Credit-supportive regulatory environment.	Limited geographic and regulatory diversity.
Mostly residential customers with minimal concentration risk.	Negative discretionary cash flow indicating external funding needs.

In response to COVID-19, the Ontario Energy Board (OEB) prohibited the disconnection of residential customers through July 31, 2020, due to nonpayment. The OEB's order may increase write-offs and bad debts along with continuing to pay for power costs. This will increase working capital requirements and require incremental borrowing under revolving credit facilities and greater issuance of commercial paper. Financial measures will weaken from the higher debt and reduced operating cash flow. Ontario utilities are accruing these costs for future rate recovery.

Alectra's strategy remains consistent with harvesting synergies from amalgamated operations and grid modernization. Alectra's projected capital expenditures are mainly on projects required to meet customer service obligations, and System renewal expenditures relate to long-term plans to replace assets that are at the end, or nearing the end, of their useful lives. The regulated rate base additions further results in more stable and predictable cost recoveries with enhanced operating efficiency.

Ontario regulatory construct permits timely cost recovery. The OEB preapproves utilities' capital programs and has not disallowed rate recovery of preapproved capital spending. There is revenue decoupling for distribution operators and fixed-rate distribution tariffs. In addition, the utility's exposure to commodity costs is limited because it passes these costs through to customers.

Outlook: Stable

The stable outlook reflects S&P Global Ratings' assessment of Alectra's predictable and stable cash flows from the company's low-risk, regulated distribution business. We expect adjusted funds from operations (FFO) to debt to be in the 12%-14% range through 2021. The outlook also reflects our expectation that management will continue to focus on integrating the amalgamated companies and its core regulated business electricity distribution over our two-year outlook horizon.

Downside scenario

We could downgrade the company over the next two years if adjusted FFO to debt declines below 12%. This would indicate very minimal cushion at the current rating level and could happen if the company cannot achieve the required synergies, costs significantly increase during the company's deferred rate rebasing period, or there is an adverse regulatory decision that materially limits cost recovery.

Upside scenario

Although less likely, we could raise the rating within the next two years if Alectra's adjusted FFO to debt approaches 20%. However, based on our financial forecast and the company's capital programs, we believe the prospect of a positive rating action is highly unlikely during our outlook horizon.

Our Base-Case Scenario

Assumptions

- Continued costs recovered through annual filings and incremental capital module riders;
- Modest customer growth in Ontario;
- Gross margin additions of about $10 million annually;
- Annual gross capital spending of about C$350 million–C$400 million per year through 2022;
- Dividends averaging about C$85 million annually;
- Negative discretionary cash flows indicate external funding needs; and
- All debt maturities are refinanced.

Key Metrics

	2019A	2020E	2021E
Adjusted FFO to debt (%)	11.5	12-14	12-14
Adjusted debt to EBITDA (x)	7.1	6-6.5	6-6.5
Adjusted FFO cash interest coverage (x)	4.5	4.5-5	4.5-5

FFO—Funds From Operations. E—Estimate. A—Actual.

Company Description

Alectra is a municipality-owned electric distribution utility in Ontario, Canada.

Business Risk: Excellent

Our assessment of Alectra's business risk reflects its fully regulated electric distribution operations in the supportive regulatory environment in the Province of Ontario and a stable customer base that is partially offset by its limited regulatory and business diversity. Alectra's customer base consists of about one million customers in Ontario that are mostly residential (over 90%) and commercial, providing stability to cash flows as exposure to industry cyclicality is limited.

We believe the OEB has provided a transparent, consistent, and independent regulatory framework that supports stable and predictable cash flows for the company, which we view as a credit strength. This includes limiting commodity risk exposure since electricity costs are passed through to ratepayers. The tariff structure allows the operator to recover prudently spent operating costs, capital expenditures, or other unexpected material losses in a timely manner. These positive aspects are partially offset by our expectation that the company is allowed to defer rebasing rates for the next decade and its operations under a single regulator. Additionally, the revenue collection deferrals due to COVID-19 relief actions may result in volatile profitability measures.

Alectra's non-utility operations include non-regulated solar generation and energy services businesses. We consider these operations riskier than the low-risk regulated operations.

Financial Risk: Significant

Alectra's financial risk profile reflects our base-case scenario that includes adjusted FFO to debt in the 12%-14% range through 2022. This incorporates gross capital spending averaging about C$350 million-C$400 million per year, regular recoveries through a capital rate surcharge, and modest customer growth. We expect adjusted FFO to debt to average about 12%-14% for Alectra, consistent with the higher range for its financial risk profile category. We expect the supplemental ratio of adjusted FFO cash interest coverage to be in the 4x-5x range and the debt leverage to be relatively aggressive for a regulated utility. This is captured through adjusted debt to EBITDA in the 6.0x-6.5x range through 2022.

Alectra's credit metrics, including adjusted FFO to debt, was lower than expected in 2019 at about 11.5%. This reflects the treatment of regulatory assets under International Financial Reporting Standards (IFRS) accounting. In 2019, Alectra incurred a shortfall of about C$40 million because energy cost exceeded energy sales, creating a regulatory asset of a similar amount. Under IFRS, this regulatory asset is treated as an offset against energy sales, reducing net income and cash flow temporarily and resulting in a lower adjusted FFO to debt and other credit metrics. For 2019, adjusting for the net shortfall, the adjusted FFO to debt would be about 13% and adjusted debt to EBITDA would be about 6.3x. We expect the company to recover this amount in its next rate application since electricity cost is a pass-through to ratepayers under the current tariff framework.

We base our assessment on our low-volatility financial benchmarks, which are the most relaxed when compared to those for a typical corporate issuer. This reflects the company's focus on low-risk regulated natural gas distribution operations and strong management of regulatory risk.

To capture the company's adjusted FFO to debt financial measure being at the stronger end of the significant category, we apply a positive comparative rating analysis modifier.

Liquidity: Adequate

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

Principal Liquidity Sources	Principal Liquidity Uses
• Estimated cash FFO of about C$310 million • Credit facility availability of C$500 million	• Debt maturities of C$180 million • Capital spending of about C$410 million • Dividends of about C$85 million

Environmental, Social, And Governance

Alectra's exposure to environmental risk is limited given that its operations are entirely in lower-risk electric distribution operations without commodity exposure. As such, from an environmental perspective, Alectra is better positioned than its counterparts with generation assets across North America. Social or governance factors have not had a material impact on the rating and are generally in line with peers'.

Government Influence

We believe there is a low likelihood that the utility's municipal owners would provide timely and sufficient extraordinary support in the unlikely event of financial distress. In our view, Alectra has a role of limited importance to the cities, given that the province, not the cities, has oversight of electricity regulation licensing, and that a private enterprise could provide the utility's services. We believe there is a limited link between Alectra and the cities, given our belief that, in a stress scenario, the cities might provide some temporary liquidity support but would be unlikely to support the utility with taxpayer dollars.

Issue Ratings - Subordination Risk Analysis

Capital structure

Alectra's capital structure consists of about C$2 billion of unsecured debt.

Analytical conclusions

We rate Alectra's senior unsecured debt the same as the issuer credit rating because it is the debt of a qualifying investment-grade utility.

Ratings Score Snapshot

Issuer Credit Rating

A/Stable/--

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:** Positive (+1 notch)

Stand-alone credit profile : a

- **Group credit profile:** a
- **Related government rating:** AA-
- **Likelihood of government support:** Low (no impact)

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
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- ARCHIVE: General Criteria: Group Rating Methodology, Nov. 19, 2013
- ARCHIVE: Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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
- 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

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	**a-**	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of April 30, 2020)*

Alectra Inc.	
Issuer Credit Rating	A/Stable/--
Senior Unsecured	A
Issuer Credit Ratings History	
26-Jan-2017	A/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.