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## Summary:
# Avangrid Inc.

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## Table Of Contents

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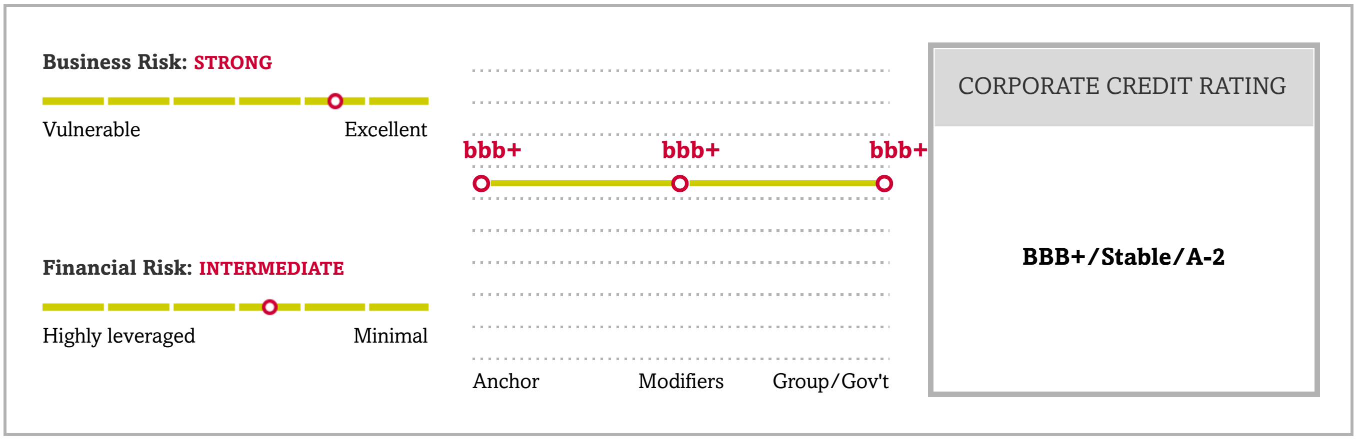


## Rationale

### Business Risk: Strong

- Lower-risk regulated electricity and natural gas utility operations contribute to about 75% of the company's consolidated EBITDA, partially offset by about 25% exposure to higher-risk unregulated renewable generation.
- Large, geographically diverse utility operations, serving about 3.2 million electricity and gas customers spanning four states.
- Expansion of Federal Energy Regulatory Commission (FERC)-regulated transmission investments add to regulatory and geographic diversity.
- Effective management of regulatory risk.

### Financial Risk: Intermediate

- We assess the Avangrid's financial measures using more relaxed financial benchmarks compared to those used for the typical corporate issuer, reflecting the company's lower-risk electricity and natural gas utility operations and effective management of regulatory risk.
- Financial metrics are consistent with the middle of the range for the financial risk profile category.
- Robust capital spending focused on the expansion of electricity transmission and distribution (T&D) and gas distribution infrastructure as well as renewable generation.

**Outlook: Stable**

The stable outlook on Avangrid Inc. mirrors that of its parent, Iberdrola S.A. (Iberdrola). S&P Global Ratings' view is that Iberdrola's business activities are highly diversified and resilient, with the majority of revenues stemming from regulated activities. At the same time, we perceive Iberdrola management as committed to the current rating and to maintaining adjusted funds from operations (FFO) to debt in the 18%-20% range over the coming two to three years. Iberdrola's FFO to debt was 18.5% at year-end 2016. However, we expect consolidated credit metrics will remain at the low end of the range until 2018. We see headroom increasing somewhat from 2019, notably once Iberdrola commissions its large renewables projects and the contribution of U.S. network activities continues increasing.

### Downside scenario

We see rating downside as remote, but pressure could arise if parent Iberdrola's cash flow and leverage weakened more than we expected, with FFO to debt below 18%. In our view, this could occur if:

- The company engaged in a large debt-financed acquisition;
- There were unexpected adverse regulation in one of Iberdrola's key markets;
- Political or country risk in Spain intensified; or
- Risks from the U.K.'s planned exit of the European Union affected operations in the U.K. and Scotland.

Other factors, in our view, include execution risks to the group's large offshore wind projects and volatility from currency risks. Although consolidated debt is adequately spread by currency, a material weakening in the U.S. dollar or pound to the euro could somewhat reduce the group's financial flexibility within the 'BBB+' rating.

### Upside scenario

Given the group's growth appetite and financial policy, we see rating upside as unlikely in coming years. Given the group's particularly strong business profile among European integrated utilities, a one-notch upgrade could ultimately depend on a combination of:

- A continuous focus on network activities in favorable regulatory frameworks and highly rated countries;
- Improving conditions in liberalized power markets and in Spain's economic environment;
- Timely delivery on the ambitious renewables pipeline; and
- A more supportive financial policy, with the company targeting adjusted FFO to debt at 20% or higher.

## Our Base-Case Scenario

Avangrid Inc.

**Assumptions**

- Consistent rate case filings at its electricity and gas distribution operations and formulaic rate recovery for the transmission operations;
- Steady growth of the renewable energy business;
- Modest utility load growth;
- Moderately negative cash flow impacts as a result of the revised U.S. corporate tax code;
- Capital spending averaging about $2.2 billion annually;
- Dividend payments of about $500 million-$600 million annually; and
- Negative discretionary cash flow.

**Key Metrics**

| | 2016A | 2017E | 2018E |
|---|---|---|---|
| FFO to debt (%) | 30.2 | 24-27 | 23-25 |
| Debt to EBITDA (x) | 2.8 | 3.1-3.4 | 3.2-3.5 |
| FFO cash interest coverage ratio(x) | 9.1 | 5-7 | 5-7 |

A--Actual. E--Estimate. FFO--Funds from operations.

## Business Risk: Strong

Our assessment of Avangrid's business risk reflects the company's lower-risk electric and gas utility operations and effective management of regulatory risk, partially offset by exposure to higher-risk renewable generation operations. Avangrid is an intermediate holding company that owns Avangrid Networks Inc. (Networks) (75%) and Avangrid Renewables Holdings Inc. (ARHI) (25%). Through its utility subsidiaries, Avangrid provides services to more than 2.2 million electricity customers in Connecticut, Maine, and New York, and more than 990,000 natural gas customers in Connecticut, Maine, Massachusetts, and New York. Avangrid is about 81.5% owned by Iberdrola and contributes to about 25% of Iberdrola's operations.

Avangrid benefits from some geographic and regulatory diversity with its utility operations spanning four states and its renewable generation business spanning 22 states. Furthermore, FERC regulates the company's transmission assets (about 20% of Networks) and the company benefits from FERC's forward-looking formula rates that include annual true-ups to recover prudently incurred costs. We view the FERC regulatory compact as supportive for credit quality.

Avangrid's regulated utility operations (Networks) engage in lower-risk, rate-regulated electricity and natural gas distribution and transmission operations and operates through eight utilities--New York State Electric & Gas Corp., Rochester Gas and Electric Corp., The United Illuminating Co., Central Maine Power Co., The Southern Connecticut Gas Co., Connecticut Natural Gas Co., Berkshire Gas Co., and Maine Natural Gas Corp. Networks operates in generally constructive regulatory environments with mostly forecast test years and reduces its risks through the use of a decoupling mechanism. Despite generally below-average authorized return on equity, the company partially mitigates this risk through the use of regulatory mechanisms and consistent rate case filings.

We ascribe significantly higher business risk to Avangrid's unregulated operations (ARHI) given its focus on renewable energy generation, and gas storage and trading. These businesses increase Avangrid's exposure to counterparty credit, volumetric, commodity, and additional operational risks. About 66% of ARHI's capacity is lower-risk long-term contracted. Avangrid continues to gradually increase the capacity under long-term contracts, adding additional cash flow stability. Moreover, Avangrid recently entered into a definitive agreement to sell its gas trading business to CCI U.S. Asset Holdings LLC, a subsidiary of Castleton Commodities International LLC (CCI), and is also pursuing the sale of its gas storage business. We view this as beneficial for the company's business risk profile as the company divests in its higher-risk noncore business.

**Table 1**

| Avangrid Inc. -- Peer Comparison | | | | | |
|---|---|---|---|---|---|
| | **Avangrid Inc.** | **NextEra Energy Inc.** | **Public Service Enterprise Group Inc.** | **Exelon Corp.** | **Berkshire Hathaway Energy Co.** |
| Rating as of Jan. 29, 2018 | BBB+/Stable/A-2 | A-/Stable/-- | BBB+/Stable/A-2 | BBB/Stable/A-2 | A/Stable/A-1 |
| | **--Fiscal year ended Dec. 31, 2016--** | | | | |
| **(Mil. $)** | | | | | |
| Revenues | 6,018.0 | 16,079.3 | 9,061.0 | 28,072.3 | 17,422.0 |
| EBITDA | 2,249.0 | 7,313.9 | 3,366.0 | 8,311.6 | 7,089.1 |
| Funds from operations (FFO) | 1,873.4 | 6,149.2 | 2,946.2 | 6,517.0 | 5,860.6 |
| Net income from cont. oper. | 630.0 | 2,912.0 | 887.0 | 1,134.0 | 2,542.0 |
| Cash flow from operations | 1,647.4 | 5,831.2 | 3,253.2 | 7,335.8 | 6,088.6 |
| Capital expenditures | 1,687.0 | 9,514.2 | 4,291.0 | 7,606.0 | 4,975.5 |
| Free operating cash flow | (39.6) | (3,683.0) | (1,037.8) | (270.2) | 1,113.1 |
| Discretionary cash flow | (440.6) | (5,429.8) | (1,867.8) | (1,456.7) | 1,113.1 |
| Cash and short-term investments | 94.0 | 1,292.0 | 424.0 | 612.0 | 721.0 |
| Debt | 6,193.9 | 22,098.6 | 12,981.3 | 36,631.3 | 40,167.3 |
| Equity | 15,122.0 | 29,261.0 | 13,130.0 | 24,959.0 | 24,493.0 |
| **Adjusted ratios** | | | | | |
| EBITDA margin (%) | 37.4 | 45.5 | 37.1 | 29.6 | 40.7 |
| Return on capital (%) | 5.6 | 7.9 | 5.3 | 4.3 | 6.2 |
| EBITDA interest coverage (x) | 5.8 | 6.0 | 6.6 | 4.4 | 3.5 |
| FFO cash int. cov. (x) | 9.1 | 6.2 | 9.3 | 5.9 | 4.3 |
| Debt/EBITDA (x) | 2.8 | 3.0 | 3.9 | 4.4 | 5.7 |
| FFO/debt (%) | 30.2 | 27.8 | 22.7 | 17.8 | 14.6 |
| Cash flow from operations/debt (%) | 26.6 | 26.4 | 25.1 | 20.0 | 15.2 |
| Free operating cash flow/debt (%) | (0.6) | (16.7) | (8.0) | (0.7) | 2.8 |
| Discretionary cash flow/debt (%) | (7.1) | (24.6) | (14.4) | (4.0) | 2.8 |

Source: S&P Global Ratings.

## Financial Risk: Intermediate

We assess Avangrid's financial measures using more relaxed financial benchmarks compared to those for the typical corporate issuer, reflecting the company's lower-risk regulated electricity and natural gas utility operations and effective management of regulatory risk. Under our base-case scenario--which includes consistent electricity and gas distribution base rate increases, formulaic transmission rates, modest utility load growth, and is partially offset by moderately negative cash flow impacts largely stemming from the revised U.S. corporate tax code, robust capital spending of about $2.2 billion annually, and dividend payments of about $500 million-$600 million annually--we expect FFO to debt of about 24%.

**Table 2**

**Avangrid Inc. -- Financial Summary**

| | --Fiscal year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| | **2016** | **2015** | **2014** | **2013** | **2012** |
| Rating history | BBB+/Stable/A-2 | BBB/Positive/-- | BBB/Stable/-- | BBB/Stable/A-2 | BBB/Stable/A-2 |
| **(Mil. $)** | | | | | |
| Revenues | 6,018.0 | 4,367.0 | 4,594.0 | 4,313.0 | 4,055.0 |
| EBITDA | 2,249.0 | 1,440.0 | 1,620.0 | 1,465.0 | 1,354.9 |
| FFO | 1,873.4 | 1,154.3 | 1,295.2 | 1,211.8 | 957.2 |
| Net income from continuing operations | 630.0 | 267.0 | 424.0 | (65) | 170.0 |
| Cash flow from operations | 1,647.4 | 1,433.3 | 1,331.2 | 1,144.8 | 712.1 |
| Capital expenditures | 1,687.0 | 1,069.0 | 1,018.0 | 935.0 | 1,779.0 |
| FOCF | (39.6) | 364.3 | 313.2 | 209.8 | (1,066.9) |
| Dividends paid | 401.0 | 0.0 | 3.0 | 0.0 | 2.4 |
| Discretionary cash flow | (440.6) | 364.3 | 310.2 | 209.8 | (1,069.2) |
| Debt | 6,193.9 | 5,639.0 | 3,100.4 | 2,981.1 | 3,827.7 |
| Preferred stock | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 |
| Equity | 15,122.0 | 15,066.0 | 12,456.0 | 12,030.0 | 3,757.7 |
| Debt and equity | 21,315.9 | 20,705.0 | 15,556.4 | 15,011.1 | 7,585.4 |
| **Adjusted ratios** | | | | | |
| EBITDA margin (%) | 37.4 | 33.0 | 35.3 | 34.0 | 33.4 |
| EBITDA interest coverage (x) | 5.8 | 4.2 | 5.3 | 5.1 | 3.8 |
| FFO cash int. cov. (x) | 9.1 | 10.3 | 11.0 | 9.6 | 6.7 |
| Debt/EBITDA (x) | 2.8 | 3.9 | 1.9 | 2.0 | 2.8 |
| FFO/debt (%) | 30.2 | 20.5 | 41.8 | 40.7 | 25.0 |
| Cash flow from operations/debt (%) | 26.6 | 25.4 | 42.9 | 38.4 | 18.6 |
| FOCF/debt (%) | (0.6) | 6.5 | 10.1 | 7.0 | (27.9) |
| Discretionary cash flow/debt (%) | (7.1) | 6.5 | 10.0 | 7.0 | (27.9) |
| Net cash flow/Capex (%) | 87.3 | 108.0 | 126.9 | 129.6 | 53.7 |
| Return on capital (%) | 5.6 | 3.4 | 6.0 | 6.9 | 10.4 |
| Return on common equity (%) | 3.9 | 1.8 | 3.2 | (1.1) | 4.1 |
| Common dividend payout ratio (un-adj.) (%) | 0.0 | 0.0 | 0.0 | 0.0 | 101.3 |

FFO--Funds from operations. FOCF--Free operating cash flow. Capex--Capital expenditures. Source: S&P Global Ratings.

## Liquidity: Adequate

Avangrid has adequate liquidity, in our view, and can more than cover its needs for the next 12 months even if EBITDA declines by 10%. We expect the company's liquidity sources over the next 12 months will exceed uses by more than 1.1x, the minimum threshold for this liquidity assessment under our criteria. Under our stress scenario, we do not expect the company to require access to the capital markets during that period to meet liquidity needs. In addition, Avangrid has sound relationships with banks and satisfactory standing in the credit markets. It could absorb a high-impact, low-probability event with limited need for refinancing.

| Principal Liquidity Sources | Principal Liquidity Uses |
| --- | --- |
| • Credit facility availability of about $1.5 billion;<br>• FFO of about $1.8 billion; and<br>• Minimal cash assumed. | • Long-term debt maturities of about $180 million in 2018;<br>• Capital spending of about $2.2 billion; and<br>• Dividend payments of about $500 million-$600 million. |

## Group Influence

Under our group rating methodology, we assess Avangrid as a core member of its ultimate parent, Iberdrola, because it is highly unlikely to be sold, is integral to the group's overall strategy, possesses significant management commitment, is a significant contributor to the group, and is closely linked to the parent's reputation. As a result, we assess our issuer credit rating on Avangrid as in line with the 'bbb+' group credit profile on Iberdrola.

## Ratings Score Snapshot

### Corporate Credit Rating

BBB+/Stable/A-2

### Business risk: Strong

- **Country risk:** Very low
- **Industry risk:** Low
- **Competitive position:** Strong

### Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

### Anchor: bbb+

### 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:** Neutral (no impact)

**Stand-alone credit profile : bbb+**

- **Group credit profile:** bbb+
- **Entity status within group:** Core (no impact)

## Issue Ratings

| Capital structure | Analytical conclusions |
|---|---|
| Avangrid's capital structure consists of approximately $5.7 billion of total debt, of which about $4.6 billion is outstanding at its subsidiaries. | • The unsecured debt issues at Avangrid are rated 'BBB', one-notch lower than the issuer credit rating. This is due to the significant proportion of priority debt at the company's subsidiaries.<br>• The commercial paper program is rated 'A-2', consistent with the issuer credit rating. |

## Reconciliation

**Table 3**

**Reconciliation Of Avangrid Inc. Reported Amounts With S&P Global Ratings' Adjusted Amounts**

| | --Fiscal year ended Dec. 31, 2016-- | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Avangrid Inc. reported amounts (Mil. $)** | | | | | | | | |
| | **Debt** | **Shareholders' equity** | **EBITDA** | **Operating income** | **Interest expense** | **EBITDA** | **Cash flow from operations** | **Capital expenditures** |
| Reported | 4,916.0 | 15,109.0 | 1,998.0 | 1,194.0 | 268.0 | 1,998.0 | 1,561.0 | 1,707.0 |
| **S&P Global Ratings' adjustments** | | | | | | | | |
| Interest expense (reported) | -- | -- | -- | -- | -- | (268.0) | -- | -- |
| Interest income (reported) | -- | -- | -- | -- | -- | -- | -- | -- |
| Current tax expense (reported) | -- | -- | -- | -- | -- | (2.0) | -- | -- |
| Operating leases | 381.1 | -- | 161.0 | 30.1 | 30.1 | 130.9 | 130.9 | -- |
| Postretirement benefit obligations/deferred compensation | 722.2 | -- | 80.0 | 80.0 | 60.3 | 32.4 | (23.6) | -- |
| Surplus cash | (94.0) | -- | -- | -- | -- | -- | -- | -- |

**Table 3**

| Reconciliation Of Avangrid Inc. Reported Amounts With S&P Global Ratings' Adjusted Amounts (cont.) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Capitalized interest | -- | -- | -- | -- | 20.0 | (20.0) | (20.0) | (20.0) |
| Asset retirement obligations | 104.7 | -- | 10.0 | 10.0 | 10.0 | 2.1 | (0.9) | -- |
| Nonoperating income (expense) | -- | -- | -- | 83.0 | -- | -- | -- | -- |
| Noncontrolling Interest/Minority interest | -- | 13.0 | -- | -- | -- | -- | -- | -- |
| Debt - Accrued interest not included in reported debt | 60.0 | -- | -- | -- | -- | -- | -- | -- |
| Debt - Other | 104.0 | -- | -- | -- | -- | -- | -- | -- |
| Total adjustments | 1,277.9 | 13.0 | 251.0 | 203.1 | 120.4 | (124.6) | 86.4 | (20.0) |

**S&P Global Ratings' adjusted amounts**

| | **Debt** | **Equity** | **EBITDA** | **EBIT** | **Interest expense** | **Funds from operations** | **Cash flow from operations** | **Capital expenditures** |
|---|---|---|---|---|---|---|---|---|
| Adjusted | 6,193.9 | 15,122.0 | 2,249.0 | 1,397.1 | 388.4 | 1,873.4 | 1,647.4 | 1,687.0 |

Source: S&P Global Ratings.

## Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- 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 Unregulated Power And Gas Industry, March 28, 2014
- 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: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - Utilities: Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 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 - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

## Business And Financial Risk Matrix

| Business Risk Profile | Financial 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- |