S&P Global
Ratings

Research

Research Update:

Alectra Inc. Outlook Revised To Stable From Negative Due To Expectation Of Reduced Regulatory Lag; Ratings Affirmed

March 20, 2024

Rating Action Overview

- We concluded our review of Ontario's regulatory construct and determined to maintain our assessment as a most credit supportive regulatory jurisdiction.
- Our assessment reflects the Ontario Energy Board's (OEB) proactively addressing regulatory lag and we now believe that its utilities, including Alectra Inc., will maintain consistent financial measures sufficient for the current ratings.
- We therefore revised our outlook to stable from negative and affirmed our ratings on Alectra, including our 'A-' issuer credit rating and senior unsecured rating.
- The stable outlook on Alectra reflects our expectation that its financial measures will remain consistent, such that funds from operations (FFO) to debt is greater than 13%. The stable outlook also reflects our expectation that the regulated utility business will consistently contribute about 90% of consolidated EBITDA. Under our base case we expect consolidated FFO to debt of 14%-16% through 2026.

PRIMARY CREDIT ANALYST

Omar El Gamal, CFA
Toronto
+1 4165072523
omar.elgamal
@spglobal.com

SECONDARY CONTACT

Matthew L O'Neill
New York
+ 1 (212) 438 4295
matthew.oneill
@spglobal.com

Rating Action Rationale

Our assessment of Ontario's regulatory environment remains unchanged as a most credit supportive regulatory jurisdiction. During 2023, OEB proactively addressed regulatory lag, particularly related to the timely recovery of rising transmission-related costs. Previously, local distribution companies' (LDCs) recovery of transmission costs included a regulatory lag of about 24 months distribution companies (LDCs) in Ontario experienced regulatory lag of about 24 months in recovering the transmission costs increases. Regulatory lag is the timing difference between when costs are incurred by the LDCs and when they ultimately recover such costs from ratepayers. Because of inflation and rising transmission capital spending, transmission costs were significantly increasing and the regulatory lag was materially weakening the financial measures of Ontario's LDCs.

However, beginning in 2024, the OEB allowed the LDCs to implement new preliminary transmission rates at about the same time that the OEB authorizes such rates for the transmission companies, substantially reducing the regulatory lag. Overall, we view the OEB's proactiveness to quickly address this regulatory lag as constructive and consistent with our view of Ontario's regulatory construct as a most credit supportive regulatory jurisdiction. As such, we expect Alectra's financial measures will be more consistent and reflect FFO to debt of 14% to 16% through 2026.

Alectra's financial risk profile assessment remains significant . Alectra's financial measures considerably improved in 2023. For 2022, FFO to debt was about 9% but in 2023 this increased to about 14%. The improvement was due to lower deferred 2023 transmission costs and higher recovery of previously deferred 2021 transmission costs. We expect financial performance to consistently remain above Alectra's downgrade threshold of FFO to debt of 13% through 2026. This incorporates annual rate increases, our expectation of minimal regulatory lag, and a consistent level of annual capital expenditures at about C$400 million to C$500 million. Furthermore, we expect 2024 financial measures to significantly improve, reflecting FFO to debt at 17% to 19% before normalizing to 14% to 16%, beginning in 2025. The near-term improvement reflects about C$130 million of authorized deferred costs recoveries. Alectra currently operates under a rate case freeze through 2026 that we assess as negative for credit quality. We expect that Alectra will file a new rate case in 2026.

We continue to assess Alectra's business risk profile as excellent. Our assessment reflects the company's lower-risk regulated electric LDC business that accounts for about 90% of consolidated EBITDA. The nonutility businesses (about 10% of EBITDA) have higher business risk compared to the lower-risk utility because the nonutility businesses rely on storm activity and restoration work, which increases the volatility of Alectra's financial performance. Our assessment of Alectra's business risk profile also reflects its large customer base (about 1.1 million customers), consisting of mostly residential customers that provide a degree of cash flow stability, and our assessment of the Ontario regulatory construct as a most credit supportive regulatory jurisdiction.

Outlook

The stable outlook on Alectra reflects our expectation that its financial measures will remain consistent, such that FFO to debt is greater than 13%. The stable outlook also reflects our expectation that the regulated utility business will consistently contribute about 90% of consolidated EBITDA. Under our base case we expect consolidated FFO to debt of 14%-16% through 2026.

Downside scenario

We could lower our ratings on Alectra within the next 24 months if its financial performance weakens, such that its FFO to debt remains consistently below 13%, or we believe its business risk has increased. This could occur if the company disproportionally expands its nonutility businesses, such that it approaches about 15% of its consolidated EBITDA.

Upside scenario

We could raise our rating on Alectra within the next 24 months if its financial measures improve, including FFO to debt consistently above 18%, without any further increase to business risk. We could also raise our rating if its nonutility businesses' contribution to its consolidated EBITDA decreases such that it approaches 5%.

Company Description

Alectra is an investment holding company that owns Alectra Utilities Corp. (about 90% of EBITDA), and Alectra Energy Solutions Inc. (about 10% of EBITDA).

Our Base-Case Scenario

- Continued rate increases driven by annual rate increases, and recoveries of deferred costs.
- Recovery of large historical transmission cost deferrals in 2024.
- Minimal energy costs deferrals through 2026.
- Capital spending averaging about C$400 to C$500 million per year through 2026.
- Minimal Discretionary cash flow deficits through 2026.
- No material disallowance of costs.
- All debt maturities are refinanced, and discretionary cash flow deficits funded by debt.

Liquidity

As of Dec. 31, 2023, we assess Alectra's liquidity as adequate, which reflects our expectation that sources will cover uses by 1.1x over the coming 12 months. Additionally, we anticipate its net sources will remain positive even if consolidated EBITDA declines 10%. We believe the predictable regulatory framework for Alectra provides cash flow stability even in times of economic stress. This supports our use of slightly lower thresholds than for a typical corporate issuer to assess the company's liquidity. In addition, Alectra has the ability to absorb high-impact, low-probability events, given that it maintains about C$700 million in committed credit facilities that mature beyond 12 months. We also believe the company can significantly lower its capital spending during stress, which would reduce the need for refinancing under such conditions. Furthermore, our assessment reflects the company's generally prudent risk management, sound relationships with its banks, and satisfactory standing in the credit markets. Overall, we believe the company could withstand adverse market circumstances over the next 12 months with sufficient liquidity to meet its obligations. The company has its next big long-term debt maturities in 2024, totaling about C$315 million coming due, and we expect the company to proactively address these maturities well in advance of their scheduled due date.

Principal liquidity sources include:

- Committed credit facilities availability of C$700 million;
- Cash FFO of about C$680 million; and,
- Cash of about C$20 million

Principal liquidity uses include:

- Debt maturities of about C$690 million
- Capital expenditure of about C$450 million; and
- Dividend payments of about C$80 million.

Issue Ratings - Subordination Risk Analysis

Capital structure

Alectra's capital structure comprises about C$2.6 billion of unsecured debt.

Analytical conclusions

We rate Alectra's senior unsecured debt at the same level as our issuer credit rating because its priority debt does not exceed 50% of its consolidated debt.

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: Neutral (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: a-

- Likelihood of government support: Low (no impact)

Related Criteria

- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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
- 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: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Alectra Inc.		
Issuer Credit Rating	A-/Stable/--	A-/Negative/--
Issue-Level Ratings Affirmed		
Alectra Inc.		
Senior Unsecured	A-	

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.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.