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NEWS & ANALYSIS

Credit implications of current events

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State regulators' use of Spire Missouri parent's capital structure in gas utility's rate case would be credit negative

Last Wednesday, regulators in Missouri suggested they would use Spire Inc.'s (Baa2 stable) equity ratio to set rates in the company's pending gas utilities distribution rate case. This would be credit negative for Spire Missouri Inc. (A1 stable), Spire Inc.'s largest gas utility, because it would reduce Spire Missouri's ability to generate earnings and cash flow and negatively affect the company's ratio of cash flow from operations pre-working capital changes to debt.

Missouri regulators would like to lower Spire Missouri's equity component in its capital structure to 48%-49% from 54% for ratemaking purposes. Spire Missouri is allowed to earn a return on the equity in its capital structure, so a lower equity component would reduce the utility's returns, all things being equal.

We estimate that the lower equity component for ratemaking purposes would reduce Spire Missouri's cash flow such that its ratio of cash flow from operations pre-working capital changes to debt would decline by about 100 basis points. The lower equity component would add incremental negative pressure on the company's financial metrics on top of the effect from the recent changes in US tax laws, which we expect will reduce Spire Missouri's ratio of cash flow from operations pre-working capital changes to debt by about 100 basis points. For the 12 months that ended 30 September 2017, Spire Missouri's ratio of cash flow from operations pre-working capital changes to debt was 20.4%.

A regulatory decision to impute a holding company's debt and equity mix down to its utility for ratemaking purposes is less credit supportive for regulated utilities. It is an uncommon practice in the industry because state regulators typically focus on the capital structure of the regulated entity and not that of the parent company, which is typically out of the regulator's jurisdiction.

On 11 April 2017, Spire Missouri's gas distribution utilities in the state's eastern and western service territories filed a general rate case application requesting a rate revenue increase totaling $108.5 million, of which $49 million was already being collected from customers through a pipeline replacement recovery mechanism. The new rates were based on a requested return on equity of 10.35% and an equity component of 54%. The company expects the new rates to go into effect in March following the regulators' final order in mid-February.

Saint Louis, Missouri-based Spire Missouri is the largest regulated natural gas distribution company in the state, serving more than 1.1 million residential, commercial and industrial customers.

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