## Ratings on Gaz Metropolitain Inc. Harmonized; Outlook Stable

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**TORONTO (Standard & Poor's CreditWire) April 23, 2001 -** Standard & Poor's today announced its single-'A' harmonized senior secured debt rating on Gaz Metropolitain Inc.'s first mortgage bonds.

At the same time, the single-'A'-minus harmonized corporate credit and the 'A-1(Low)' Canadian national scale commercial paper ratings on the company were announced. The outlook is stable.

On Oct. 31, 2000, Standard & Poor's and the Canadian Bond Rating Service (CBRS) announced that they have combined operations in Canada. A process is underway to harmonize all ratings assigned by CBRS with the Standard & Poor's framework, which includes the translation of all ratings onto the Standard & Poor's global ratings scale. Going forward, all new debt issue ratings on Gaz Metropolitain will be based on the harmonized corporate credit rating. Ratings harmonization announcements do not constitute upgrades or downgrades of ratings assigned by CBRS, nor do they signify any changes in an issuer's underlying credit quality, unless explicitly indicated. Ratings on specific debt issues previously assigned by CBRS to the company will remain in effect until May 1, 2001, when they will be formally withdrawn (unless superceded in light of credit-related rating actions in the interim). The ratings on Gaz Metropolitain reflect:

- Ninety-seven percent of the company's revenues are regulated, making it a "pure" utility. Its various operations are regulated by four different agencies (the Regie de l'Energie, National Energy Board, Federal Energy Regulatory Commission, and the Vermont Public Service Board), which helps diversify risk.

- Core gas distribution assets (located in Quebec and Vermont) account for 78% of consolidated assets and 86% of consolidated EBITDA. The Quebec distribution assets are subject to performance-based regulation (effective October 2000) with any downside risk limited to the cost of service and rate of return method. Current regulation protects the company from any commodity risk, which is a direct flow-through to distribution customers.

- Quebec distribution assets are fairly new and efficient, and continue to grow at a modest pace with a renewed focus on the residential market. Gaz Metropolitain added 2,600 new residential customers in 2000, compared with 1,350 in 1999 and 815 in 1998. The relatively untapped residential Quebec market offers great opportunities; however, the rise in natural gas prices has materially slowed near-term growth prospects, especially in the space heating (conversion) market. Recent rate base growth has been generated primarily by the transmission business with the completion of the Portland Natural Gas

Transmission System and the TransQuebec and Maritimes Pipeline extension. Furthermore, Gaz Metropolitain is proposing, jointly with Enbridge Inc. (senior unsecured debt rating: single-'A'), to build a new 164-km pipeline interconnecting natural gas supplies on Canada's East Coast with large and established markets in Central Canada. The Cartier Pipeline would cost about C$270 million and have an in-service date of November 2004. Gaz Metropolitain's transmission business accounted for about 20% of consolidated assets and 13% of consolidated EBITDA in 2000.

- Continued modest growth in the utility's nonregulated business, primarily through acquisitions. Gaz Metropolitain recently acquired an interest in two small water infrastructure management companies (Aqua-Rehab Inc. and Aqua Data Inc.) and an interest in VDN Cable. These acquisitions offer good upside opportunities and some diversification.

- Demonstrated ability to maintain a stable capital structure, sound coverage ratios, and good cash flow-generating capabilities. This is mainly attributable to good management, stabilization accounts, and a regulated capital structure. The company's total debt to total capital at 60%, funds from operations (FFO) to average total debt at 22%, and FFO interest coverage ratio of 4.0 times continue to measure within the parameters of its current ratings category.

- Strong shareholder support from Hydro Quebec (50% owned; senior unsecured debt rating: single-'A'-plus), Enbridge (32%), and Gaz de France (18%; long-term corporate credit rating: triple-'A').

The ratings are partly offset by the following factors:

- Abundant natural gas reserves insure the security of short- to medium-term supply; however, high gas prices have significantly narrowed the price advantage natural gas has traditionally enjoyed over electricity. This has recently resulted in natural gas becoming more expensive than oil and, in some cases, electricity, thus increasing the company's market risk. Price volatility in energy markets combined with the flexibility of large load customers to switch energy sources highlights how quickly competitive conditions can change. In 2000, 48% of revenues came from industrial customers; 35% from commercial customers, and 17% from residential customers. Gaz Metropolitain has partly mitigated its heavy exposure to the industrial sector by engaging industrial customers to long-term take-or-pay contracts.

- Reliance on the industrial customer base exposes the company to economic slowdowns and cyclical commodity prices.

- Involvement in nonregulated activities is limited to 10% of Gas Metropolitain's assets by the utility's trust deed.

## OUTLOOK: STABLE

The outlook reflects the expectation of a stable regulatory regime and steady earnings growth due to the company's growing asset base. Gaz Metropolitain's growth strategy will focus primarily on increasing the share of natural gas in Quebec's energy balance, diversifying its gas supply sources away from the Canadian Western basin (Sable Island, the U.S. Midwest, and the Gulf of Mexico), increasing earnings through performance-based regulation, diversifying its sources of regulated revenues, and generating some growth with nonregulated activities, Standard & Poor's said.

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## Gaz Metropolitain, Inc. - Confirms at "A" & R-1 (low)

January 15,2001.3:18PM

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| ***Rating*** | ***Trend*** | ***Rating Action*** | ***Debt Rated*** |
|---|---|---|---|
| "A" | Stable | Confirmed | First Mortgage Bonds/Secured Debt |
| R-1 (low) | Stable | Confirmed | Commercial Paper |

DBRS is confirming the commercial paper and long-term debt ratings of Gas Métropolitain, Inc. at R-1 (low) and "A" respectively, with Stable trends, based on the following considerations. Over the longer term, regulated operations, which account for the majority of consolidated earnings, contribute to relative earnings and financial stability. Earnings over the near term are expected to be adversely affected by slightly lower approved ROEs for both domestic distribution and transmission operations and competitive pressures from alternative sources of energy. These pressures should be partially offset by incentive earnings from a new 5-year performance agreement and cost control efforts underway. A slow down in the Canadian economy could potentially lead to a further decline in interest rates and approved ROEs in F2002. With two major capital projects now complete and annual capital expenditures stabilizing in the $90 million range, the Company is now generating material cash flow surpluses. Over the next year, these surpluses will be largely offset by higher working capital needs related to rising gas prices, but over longer term they represent a material source of cash that can be re-invested in income generating businesses. Gaz Métropolitain must also contend with a number of longer-term challenges, one of which is currently adversely affecting earnings and cash flows. Given material capacity underutilization, the Company's return on its investment in the PNGTS pipeline is expected to remain negligible until 2002 when it will apply to the regulator (FERC) to adjust tolls so that it will be able to generate earnings reflective of the approved ROE. The Company's other major challenge is to improve the low market penetration of gas use in Québec. Rising gas prices will make this difficult over the near term, but a potential pipeline lateral from the Sable Island gas fields would significantly shorten the long distances from current sources of supplies and improve the cost advantage of gas relative to competing sources of energy.

***Dominion Bond Rating Service Limited (DBRS) will publish a full report shortly that will provide additional analytical detail on this rating action. If you are interested in purchasing this report, please contact us at:*** info@dbrs.com**.**

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# Gaz Métropolitain, Inc.

(Based on the Guarantor, Gaz Métropolitain and Company, Limited Partnership)

Current Report: January 15, 2001
Previous Report: January 28, 2000

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## RATING

| Rating | Trend | Rating Action | Debt Rated |
|---|---|---|---|
| "A" | Stable | Confirmed | First Mortgage Bonds/Secured Debt |

## RATING HISTORY (as at Dec. 31)

| | Current | 2000 | 1999 | 1998 | 1997 | 1996 |
|---|---|---|---|---|---|---|
| First Mortgage Bonds/Secured Debt | "A" | "A" | "A" | "A" | "A" | "A" |

## RATING UPDATE

DBRS is confirming the long-term debt rating of Gaz Métropolitain, Inc. ("Gaz Métro" or "the Company") at "A" with a Stable trend, based on the following considerations. Over the longer term, regulated operations, which account for the majority of consolidated earnings, contribute to relative earnings and financial stability. Earnings over the near-term are expected to be adversely affected by slightly lower approved ROEs for both domestic distribution and transmission operations and competitive pressures from alternative sources of energy. These pressures should be partially offset by incentive earnings from a new five-year performance agreement and cost control efforts underway. A slow down in the Canadian economy could potentially lead to a further decline in interest rates and approved ROEs in F2002. With two major capital projects now complete and annual capital expenditures stabilizing in the $90 million range, the Company is now generating material cash flow surpluses. Over the next year, these surpluses will be partially offset by higher working capital needs related to rising gas prices, but over longer term they represent a material source of cash that can be re-invested in income generating businesses. Gaz Métro must also contend with a number of longer-term challenges, one of which is currently adversely affecting earnings and cash flows. Given material capacity under-utilization, the Company's return on its investment in the PNGTS pipeline is expected to remain negligible until 2002 when it will apply to the regulator (FERC) to adjust tolls so that it will be able to generate earnings reflective of the approved ROE. The Company's other major challenge is to improve the low market penetration of gas use in Québec. Rising gas prices will make this difficult over the near-term, but the proposed pipeline lateral from the Sable Island gas fields would significantly shorten the long distances from current sources of supplies and improve the cost advantage of gas relative to competing sources of energy.

## RATING CONSIDERATIONS

_Strengths_:

- Regulation contributes to relative earnings and financial stability
- Operating cash flows more than sufficient to finance capital expenditures
- Investments in pipelines and non-domestic operations enhance and diversify earnings base

_Challenges_:

- Under-utilized transmission capacity; return on PNGTS investment will remain negligible over near-term
- Competitive pressures from dual energy industrial users, subsidized electricity rates
- Earnings sensitivity to interest rates (approved ROEs) and economic cycle (customer segment concentration)

## FINANCIAL INFORMATION

| | Industry Avg.* | For years ended September 30 | | | | |
|---|---|---|---|---|---|---|
| | _Sep-00_ | 2000 | 1999 | 1998 | 1997 | 1996 |
| Fixed Charges Coverage (times) | _1.95_ | 2.67 | 2.39 | 2.69 | 2.70 | 2.62 |
| % Debt in the Capital Structure | _63.5%_ | 61.1% | 59.7% | 60.4% | 56.1% | 55.8% |
| Cash Flow/Total Debt (times) | _0.13_ | 0.21 | 0.20 | 0.20 | 0.28 | 0.30 |
| Cash Flow/Capital Expenditures (times) | _0.47_ | 3.09 | 1.32 | 1.05 | 3.08 | 2.71 |
| Approved ROE - Domestic Gas Distribution | - | 9.72% | 9.64% | 10.75% | 11.50% | 12.00% |
| Operating Income ($ millions) | - | 231.5 | 205.2 | 200.4 | 225.0 | 241.5 |
| Net Income ($ millions) | - | 143.7 | 135.8 | 140.7 | 138.7 | 145.8 |
| Operating Cash Flow ($ millions) | - | 265.9 | 234.1 | 231.7 | 257.9 | 275.7 |
| Domestic Distribution Throughputs (Bcf) (1) | - | 231.5 | 224.8 | 224.5 | 227.9 | 218.4 |
| Transmission Throughputs (Bcf) (2) | - | 206.7 | 138.7 | 117.7 | 124.8 | 121.3 |

* DBRS Industry composite for Cdn gas distributors. (1) Weather normalized volumes. (2) Unadjusted for Gaz Metro's ownership interest.

THE COMPANY **_Gaz Métropolitain, Inc._** is the general partner of **_Gaz Métropolitain and Company, Limited Partnership_** ("GMCLP") and currently owns 77.4% of the partnership units. Gaz Métro is indirectly owned by Hydro-Québec (41%, excluding an option on an additional 9% owned by others), Enbridge Inc. (32%) and Gaz de France (18%). Gaz Métro acts as a financing vehicle for GMCLP, raising funds as required and down-lending on a back-to-back basis. GMCLP is actively involved in gas distribution and transmission.



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## BASIS OF ANALYSIS

The rating of Gaz Métropolitain Inc. is based on the guarantor, Gaz Métropolitain and Company, Limited Partnership. GMCLP owns gas distribution operations in Québec and in the U.S. (Northern New England Gas Corporation - "NNEG"), as well as an indirect 50.1% interest in a propane distributor (held by NNEG) whose franchise overlaps that of NNEG. GMCLP's gas pipeline interests include: (1) a 50% ownership stake in the Trans Québec & Maritimes Pipeline ("TQM" - see separate report); (2) two cross-border (Ontario-Québec) pipelines (Champion Pipe Lines); and (3) an indirect (held by NNEG) 19.1% ownership interest in a U.S. pipeline (Portland Natural Gas Transmission System – "PNGTS") that runs from the Québec/U.S. border to Boston.

## REGULATION

Domestic gas distribution operations are regulated by the Régie de l'énergie ("Régie"), based on a cost of service/rate of return methodology. The approved ROE for 2001 has been set at 9.60%, down from 9.72% the previous year, consistent with the trend in long-term interest rates. Deemed equity remains unchanged at 38.5%.

Effective F1998, the Régie adopted a formula-based mechanism to determine approved ROEs. The mechanism consists of two components: (1) The (typically) August Consensus Forecast yield for ten-year bonds plus the market spread between Canada ten- and thirty-year bond yields; and (2) 75% of the variance in the August forecast rate or return on 30-year Canada bonds. The formula incorporates a 384 basis point equity risk premium.

Gas costs are flowed through to the consumer, (the Utility makes no profit on the sale of the commodity), with price adjustments made on a monthly basis.

Domestic gas distribution operations will be subject to a new incentive agreement for F2001-F2005 that will allow the Company to retain a share of the productivity gains it generates as a performance incentive. Under the previous incentive-based regulation methodology (F1994-F1999), rates were rebased every year to reflect the previous year's over-earnings, thus creating no incentive for further productivity improvements. In F2000, these over-earnings amounted to $6.0 million ($11.1 million in F1999, $5.6 million in F1998), which will be shared equally with customers next year. Gaz Métro will recognize its share of the over-earnings in F2001.

Trans Québec & Maritimes Pipeline is regulated by the National Energy Board based on a cost of service/rate of return methodology. The multi-pipeline rate of return for 2001 has been set at 9.60%, down from 9.90% for 1999. TQM is also subject to incentive regulation that allows for an equal sharing of cost savings over the 1997-2001 period.

U.S. gas distribution operations, Vermont Gas Systems Inc. are regulated by the Vermont Public Service Board on a compliant basis, based on a cost of service/rate of return methodology. The approved ROE remains at 11.25% and deemed equity is set at 61% (well above applicable approved ROEs and allowed deemed equity for Canadian gas distributors set in the 9.6%-9.7% range and 35%-40% range respectively). Propane distribution operations are not regulated.

Portland Natural Gas Transmission System is regulated by the U.S. Federal Energy Regulatory Commission ("FERC"). The ROE and deemed equity for the 1999-2001 period has been set at 14% and 30% respectively (well above applicable approved ROEs and deemed equity for Canadian pipelines set at about 9.60% and 30% respectively).

## RATING CONSIDERATIONS

Strengths: (1) *Cost of service regulatiion contributes to relative earnings and financial stability*. Regulated operations account for the bulk of earnings. Domestic gas operations are permitted to utilize several deferral accounts that smooth the earnings impact of: (a) weather-induced revenue fluctuations; and (b) interest rate fluctuations on floating rate debt, both of which are amortized and recovered in future rates over a five-year period. Note that these deferral accounts do not impact cash flows and artificially inflate interest coverage ratios over the short-term (i.e., during periods of warmer than normal temperatures) but the impact is reversed as deferral balances are recovered.

(2) *Operating cash flows more than sufficient to finance capital expenditures*. With the completion of two major capital projects and the decline in capital expenditures, Gaz Métro is generating substantial free cash flow surpluses, which could potentially be used to reduce outstanding debt and/or reinvested in other income generating business opportunities.

(3) *Continued diversification into pipelines and non-domestic operations.* This diversification should reduce the Company's exposure to Québec-based distribution operations. These operations currently account for about 10% of consolidated net earnings and 19% of total assets.

(4) *Key debt ratios among the strongest in the industry*. Gaz Métro's key debt ratios compare favourably (both on a consolidated and non-consolidated basis) relative to its peer group. As at September 2000, cash flow/total debt on a *non-consolidated* basis was 0.26X and fixed charges coverage 3.33X versus industry composites of 0.13X and 1.95X for Canadian gas distributors.

(5) *Non-taxable status due to limited partnership structure.* The Company became non-taxable as a result of its 1991 corporate re-organization into a limited partnership. However, revenues include income taxes that are deemed payable by unitholders.

(6) *Extension of domestic distribution franchise.* The recent regulatory approval to extend the domestic gas distribution network into new service regions, should favourably impact the longer-term earnings outlook of Québec-based distribution operations.

<u>Challenges</u>: (1) *Material underutilized transmission capacity on PNGTS.* While this is fairly typical of new systems and capacity utilization should improve over the next few years, current volume throughputs on the PNGTS are insufficient to generate the authorized rate of return. Net earnings on the PNGTS capital investment are presently negligible but sufficient to meet cash expenses.

(2) *Sensitivity to economic cycle.* About 60% of gas volumes are delivered to industrial customers, and another 30% to commercial customers, both of whom are sensitive to economic cycles. Because of the competitive situation vis-à-vis electricity, Gaz Métro lacks a meaningful residential customer base, which could help offset the earnings sensitivity to economic cycles.

(3) *Sensitivity to interest rates.* A 25 basis point change in approved ROEs would impact net earnings by about $2.25 million. Approved ROEs have been falling steadily over the last few years, consistent with the trend in long-term interest rates, negatively affecting interest coverage ratios over the period. Note that this sensitivity increases along with growth in the rate base. An economic slow down and/or recession in Canada could lead to a further decline in interest rates and approved ROEs.

(4) *Low market penetration contributes to relatively high cost structure.* While the low market penetration of natural gas in Québec [16%, or about one-half of the Canadian average of 33% as defined by Statistics Canada] represents a potential growth opportunity, it contributes to a relatively high cost structure. Market penetration is well below the national Canadian average due to: (a) heavily subsidized residential electricity rates (home heating is largely electricity-based); (b) extensive use of fuel oil and dual fuel switching capabilities in the industrial market segment; and (c) long distances from sources of gas supplies. These factors reduce and/or eliminate the competitive price advantage of gas over alternative sources of fuel.

(5) *Contingent liabilities for TQM and PNGTS cost overruns.* The Contractor is suing for cost differences that are not presently included in rate base and may not be recoverable in future tolls. TQM's cost overruns amount to about $57 million (original cost estimate $257 million), 50% of which would flow through to Gaz Métro. PNGTS' cost overrun amount to US$90 million (original cost estimate US$455 million), 20% of which would flow through to Gaz Métro.

(6) *Forecast risk.* The accuracy of forecast distribution volumes is a key business risk, given the forward test year method of rate setting. The ability to realize the approved rate of return is dependent on achieving the forecast volumes to generate the revenues required to recover the cost of providing the services. Achievement of forecast distribution volumes is largely contingent upon economic conditions. Other material factors that may materially influence forecasts include the relative cost advantage of gas versus alternative sources of fuel and projected customer additions.

(7) *Tax accounting methodology adversely impacts coverage ratios.* The use of the flow-through method of accounting for income taxes (standard practice in Canada) has resulted in an unrecorded deferred income tax liability of $188.1 million as at September 2000. The flow-through method results in lower revenue collections, thereby reducing operating income and interest coverage ratios. The recovery of this liability in future rates is not assured.

## EARNINGS

EBIT were up sharply in F2000 to $231.5 million compared to $205.2 million last year, although higher interest costs related to the investment in the TQM pipeline extension and the new PNGTS pipeline partially offset the gain to net earnings. All segments contributed to the EBIT improvement, as follows.

<u>Distribution</u> operations benefited from an 80 basis point increase in the approved ROE for domestic gas operations, the increase in oil prices, which eased competitive pressures in the industrial customer segment, and a 3% increase in weather normalized throughputs (3.7% increase in actual throughputs). Although temperatures were well below normal (degree day deficiency - 87.8% days normal), the use of weather normalization deferral accounts helped offset the adverse impact on earnings (increasing earnings by about $29 million, similar to the impact recorded in F1999). The current year's earnings also include about $5.5 million (versus $2.8 million last year) in the Company's share of over-earnings generated in F1999. During F2000 domestic gas distribution operations generated $6 million in over-earnings, which will be shared equally with customers and recognized in next year's earnings.

<u>Transmission</u> operations benefited from a 32 basis point increase in the approved ROE applicable to domestic pipeline operations, as well as a full year's earnings contribution from the TQM pipeline extension and the PNGTS pipeline, which became operational in March 1999. The PNGTS system continues to operate well below full capacity (currently at about 60%). While earnings are sufficient to cover expenses, the pipeline operation is not currently able to generate its allowed earnings based on a 14% approved ROE and the Company's equity investment (19.1% indirect ownership interest) is not contributing to net earnings.

<u>Energy Services & Other</u> includes certain start-up costs and reflects less than a full year's earnings contribution as a result of the timing of several small acquisitions and investments in water and fibre optic services companies.

| **Segmented Earnings** | % Change 2000 - 1999 | ($ millions) 2000 | 1999 | 1998 |
|---|---|---|---|---|
| Gross Revenues | | | | |
| Distribution | 22.6% | 1,530.4 | 1,248.2 | 1,142.4 |
| Transmission | 35.5% | 58.0 | 42.8 | 29.9 |
| Energy Services & Other | 50.2% | 40.4 | 26.9 | 24.2 |
| Consolidated Gross Revenues | 23.6% | 1,628.7 | 1,317.9 | 1,196.5 |
| Operating Income | | | | |
| Distribution | 9.0% | 198.1 | 181.7 | 184.2 |
| Transmission | 43.6% | 32.1 | 22.4 | 16.1 |
| Energy Services & Other (incl unallocated) | 23.8% | 1.3 | 1.0 | 0.1 |
| Consolidated Operating Income (EBIT) | 12.8% | 231.5 | 205.2 | 200.4 |
| Interest Expense | | | | |
| Distribution | 9.7% | 65.0 | 59.3 | 55.2 |
| Transmission | 87.1% | 20.8 | 11.1 | 5.7 |
| Energy Services & Other (incl unallocated) | nmf | 2.0 | (1.0) | (1.3) |
| Consolidated Net Interest Expense | 26.5% | 87.8 | 69.4 | 59.6 |
| Net Income | | | | |
| Distribution | 8.2% | 135.2 | 124.9 | 130.1 |
| Transmission | -0.2% | 12.0 | 12.1 | 10.8 |
| Energy Services & Other (incl unallocated) | nmf | (3.5) | (1.2) | (0.2) |
| Consolidated Net Income | 5.9% | 143.7 | 135.8 | 140.7 |
| Weather normlized distribution throughputs (Bcf) | 3.0% | 231.5 | 224.8 | 224.5 |
| Transmission throughputs (Bcf) | 49.1% | 206.7 | 138.7 | 117.7 |

***Outlook***: Domestic gas distribution and pipeline operations, which account for the bulk of consolidated earnings, will both be subject to lower approved ROEs of 9.60% in F2001 (versus 9.72% and 9.9% respectively for distribution and transmission operations in F2000). A slowdown in the Canadian economy could potentially lead to a further decline in interest rates and approved ROEs in F2002. Earnings in F2001 will also be adversely affected by competitive pressures in domestic markets from alternative sources of energy, particularly if oil prices continue to fall. This exposure is, however, limited to the variance relative to forecast industrial demand volumes. Over the near-term, the recent increase in gas prices versus low electricity prices in Québec will make it difficult for the Company to improve the low market penetration of gas use in the province. In addition, if current high gas prices persist, the Company may find it difficult to secure long-term sales contracts with dual energy industrial customers. A longer-term concern is the capacity under-utilization of the PNGTS pipeline. The investment will likely continue to underperform over the next two years as the Company has committed to maintain current tolls, but PNGTS will be permitted to adjust rates in accordance with the cost of service methodology/rate of return methodology after March 2002. Two factors may help offset these near term challenges; (1) a new five-year (F2001-F2005) performance incentive mechanism that will allow Gaz Métro to retain a greater share of the productivity gains it generates as a performance incentive and (2) cost control efforts, including a 10% (voluntary) reduction in personnel over the next one-and-a-half years.

## FINANCIAL PROFILE

Operating cash flows benefited from the full year's contribution of the TQM extension and the PNGTS pipeline (i.e. higher depreciation expenses and earnings), increasing to $265.9 million versus $234.1 million last year. Although investments (capital expenditures and other investments) dropped sharply to $143 million compared to $242 million last year as a result of the completion of the TQM and PNGTS projects, sharply higher working capital needs related to rising natural gas prices contributed to a marginal increase in the debt-to-capital ratio to 61.1% compared to 59.7% last year.

EBIT interest coverage ratios improved as a result of the earnings contribution from the fully operational TQM and PNGTS systems.

| For years ended September 30 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|
| Net income | 143.7 | 135.8 | 140.7 | 138.7 | 145.8 | 135.0 | 123.6 |
| Depreciation + amortization | 122.9 | 107.9 | 102.6 | 93.4 | 89.0 | 83.5 | 79.4 |
| Rate stabilization | (29.1) | (30.4) | (26.2) | 4.3 | 5.4 | (10.9) | 10.0 |
| Other non-cash charges | 28.2 | 20.8 | 14.6 | 21.6 | 35.5 | 40.9 | 39.8 |
| **Operating Cash Flow** | 265.9 | 234.1 | 231.7 | 257.9 | 275.7 | 248.5 | 252.8 |
| LESS: Capital expenditures | 86.0 | 176.8 | 221.7 | 83.7 | 101.7 | 129.7 | 97.7 |
| Cash flow before working capital changes | 179.8 | 57.2 | 10.0 | 174.3 | 174.0 | 118.9 | 155.2 |
| LESS: Working capital changes | 75.8 | (12.5) | (0.0) | 10.3 | (22.7) | (4.8) | 27.1 |
| Free Cash Flow before distributions | 104.0 | 69.7 | 10.0 | 164.0 | 196.7 | 123.7 | 128.0 |
| LESS: Distributions | 137.0 | 134.7 | 138.5 | 142.2 | 141.7 | 132.9 | 120.9 |
| Free Cash Flow after distributions | (33.0) | (65.0) | (128.4) | 21.8 | 55.1 | (9.2) | 7.1 |
| LESS: Net investments | 56.6 | 65.6 | 44.1 | 36.2 | 43.8 | 111.6 | 146.4 |
| PLUS: Net debt financing | 84.1 | 52.6 | 195.3 | (8.2) | (0.8) | 53.6 | 53.7 |
| PLUS: Net equity financing (1) | 0.4 | 59.0 | 3.2 | 0.0 | 0.0 | 74.0 | 52.7 |
| Net Change in Cash Flows | (5.1) | (19.0) | 25.9 | (22.5) | 10.4 | 6.8 | (32.9) |
| Cash flow/Capital expenditures (times) | 3.09 | 1.32 | 1.05 | 3.08 | 2.71 | 1.92 | 2.59 |
| Cash flow/Total debt (times) | 0.21 | 0.20 | 0.20 | 0.28 | 0.30 | 0.27 | 0.28 |
| % debt in the capital structure (2) | 61.1% | 59.7% | 60.4% | 56.1% | 55.8% | 56.1% | 57.6% |
| Fixed charges coverage (times) | 2.67 | 2.39 | 2.69 | 2.70 | 2.62 | 2.55 | 2.55 |

(1) Includes minority interest which DBRS treats as a common equivalent. (2) Receivable sales treated as s-t debt financings.

***Outlook***: Operating cash flows are expected to be relatively flat in F2001 and may be adversely affected by slightly lower approved ROEs for domestic gas distribution and transmission operation and competitive pressures from alternative sources of energy. With no major capital projects underway and assuming that there are no large acquisitions, annual capital expenditures should be in the $90 million range. Some of the surplus operating cash flows will be offset by higher working capital investments required to finance natural gas inventories at substantially higher costs this winter than last (spot gas prices are about 3x higher). Short-term borrowing needs are expected to increase as a result, but DBRS expects that the Company will either adjust distributions and/or make the necessary equity injection to maintain the deemed capital structure for regulated subsidiaries, leaving consolidated balance sheet leverage relatively unchanged. Interest coverage and cash flow/total debt ratios may come under some pressure as a result of earnings pressures from dual fuel customers switching some consumption to oil (domestic gas distribution). DBRS does not consider this potential weakening a significant concern given that Gaz Métro has among the strongest ratios in the industry.

| | **Gaz Métropolitain** | | **Gas Industry** |
|---|---|---|---|
| As at Sep-00 | **Non-Cons'd** | **Consol'd** | **Composite** |
| Cash flow/total debt | 0.26X | 0.21X | 0.13X |
| Fixed charges coverage | 3.33X | 2.67X | 1.95X |

**Cartier Pipeline Project**

Gaz Métro and Enbridge Inc. have announced a proposal to jointly develop and construct a gas pipeline to bring Sable Island natural gas into Québec. The 262-km proposed *Cartier Pipeline*, which is estimated to cost about $270 million, would run parallel to the St. Lawrence River from the New Brunswick-Québec border, connecting to the existing transmission grid in Québec city. Construction would be co-ordinated with the Maritimes & Northeast Pipeline's construction of a new lateral through New Brunswick from an existing line that currently runs through Nova Scotia. The initial capacity will be 184 million cubic feet per day, but capacity could be cost effectively expanded to 340 million cubic feet per day. Regulatory filings with the NEB are expected in the spring of 2002, with an anticipated in-service date late in 2004.

Gaz Métro's proportionate share of the cost (approximately $135 million) will be financed with internally generated cash flows and new borrowings, with financing arrangements likely put into place in mid to late 2002.

## Operating Lines of Credit

The commercial paper program is fully supported by a revolving, committed $300 million loan agreement with a syndicate of nine banks. In addition, the Company has $193 million in non-committed lines of credit available for general corporate needs.

## Debt Maturity Schedule

| | F2001 | F2002 | F2003 | F2004 | F2005 |
|---|---|---|---|---|---|
| (As at Sept. 30) ($ millions) | 3.7 | 3.8 | 63.8 | 3.0 | 3.0 |

Debt maturities are generally well spread out. Although the Company is exposed to refinancing risk, DBRS does not expect Gaz Métropolitain will have any difficulty refinancing maturities in F2003

## Gaz Metropolitain and Company, Limited Partnership
**(Consolidated)**

**Balance Sheet**

| ($ millions) | As at September 30 | | | | As at September 30 | | |
|---|---|---|---|---|---|---|---|
| Assets: | 2000 | 1999 | 1998 | Liabilities & Equity: | 2000 | 1999 | 1998 |
| Cash | 4.1 | 9.2 | 28.2 | S.T. debt | 33.2 | 45.8 | 45.0 |
| Accounts receivable | 74.3 | 41.3 | 54.5 | A/P + accr'ds. | 228.5 | 199.7 | 183.6 |
| Inventories | 207.6 | 132.9 | 106.0 | L.t.d. due in 1 year | 3.7 | 11.3 | 10.1 |
| Prepaid expenses | 8.5 | 12.3 | 18.5 | Current Liabilities | 265.4 | 256.8 | 238.7 |
| Current Assets | 294.5 | 195.7 | 207.2 | Long-term debt | 1,189.8 | 1,082.4 | 1,034.8 |
| Net fixed assets | 1,740.6 | 1,727.5 | 1,628.5 | Minority interest | 1.8 | 2.0 | 2.9 |
| Rate stabilization acct | 77.8 | 54.9 | 24.8 | Partners' equity | 806.0 | 796.8 | 740.9 |
| Deferred + other assets | 125.4 | 134.5 | 132.9 | | | | |
| Goodwill | 24.7 | 25.4 | 23.8 | | | | |
| Total | 2,262.9 | 2,138.0 | 2,017.3 | Total | 2,262.9 | 2,138.0 | 2,017.3 |

| **Ratio Analysis** (1) | *Industry Avg.** | Equity Acctg. | For years ended September 30 | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Liquidity Ratios** (2) | *Sep-00* | 2000 | 2000 | 1999 | 1998R | 1997 | 1996 | 1995 |
| Current ratio | *0.91* | 1.20 | 1.09 | 0.80 | 0.89 | 0.73 | 0.81 | 0.68 |
| Accumulated depreciation/Gross fixed assets | *28.0%* | 30.5% | 29.7% | 27.9% | 27.2% | 27.2% | 25.6% | 24.2% |
| Cash flow/Total debt | *0.13* | 0.26 | 0.21 | 0.20 | 0.20 | 0.28 | 0.30 | 0.27 |
| Cash flow/Capital expenditures | *1.09* | 3.36 | 3.09 | 1.32 | 1.05 | 3.08 | 2.71 | 1.92 |
| Cash flow-dividends/Capital expenditures | *0.47* | 1.45 | 1.50 | 0.56 | 0.42 | 1.38 | 1.32 | 0.89 |
| % Debt in capital structure | *63.5%* | 53.6% | 61.1% | 59.7% | 60.4% | 56.1% | 55.8% | 56.1% |
| Average coupon on long-term debt | *8.75%* | 7.86% | 7.65% | 8.05% | 8.26% | 9.49% | 9.76% | 10.70% |
| Deemed common equity (domestic gas distribution) | *36%* | 38.5% | 38.5% | 38.5% | 38.5% | 38.5% | 38.5% | 38.5% |
| Deemed common equity (US gas distribution) | - | 63.3% | 63.3% | 63.3% | 63.3% | 66.8% | 66.8% | - |
| Deemed common equity (TQM - pipeline) | - | 30.0% | 30.0% | 30.0% | 30.0% | 30.0% | 25.0% | 25.0% |
| Deemed common equity (PNGTS - US pipeline) | - | 30.0% | 30.0% | 30.0% | 30.0% | - | - | - |
| Common dividend payout (before extras.) | *126.7%* | 95.3% | 95.3% | 99.2% | 98.4% | 102.5% | 97.1% | 98.4% |
| **Coverage Ratios** (3) | | | | | | | | |
| EBIT interest coverage | *2.11* | 3.33 | 2.67 | 2.39 | 2.69 | 2.70 | 2.62 | 2.55 |
| EBITDA interest coverage | *3.05* | 4.90 | 4.04 | 3.62 | 4.01 | 3.81 | 3.57 | 3.47 |
| Fixed charges coverage | *1.95* | 3.33 | 2.67 | 2.39 | 2.69 | 2.70 | 2.62 | 2.55 |
| **Earnings Quality/Operating Efficiency & Statistics** | | | | | | | | |
| Operating margin | *40.5%* | 46.3% | 43.8% | 43.1% | 43.5% | 47.3% | 50.9% | 49.6% |
| Net margin (before extras.) | *15.5%* | 34.4% | 27.2% | 28.5% | 30.6% | 29.2% | 30.7% | 29.3% |
| Return on partners equity (before extras.) | *10.8%* | 17.9% | 17.9% | 17.7% | 19.1% | 18.9% | 19.9% | 19.5% |
| Approved ROE (domestic gas distribution) | - | - | 9.72% | 9.64% | 10.75% | 11.50% | 12.00% | 12.00% |
| Approved ROE (US gas distribution) | - | - | 11.25% | 11.25% | 11.25% | 11.25% | 11.25% | - |
| Approved ROE (TQM - pipeline) | - | - | 9.90% | 9.58% | 10.21% | 10.67% | 11.25% | 12.25% |
| Approved ROE (PNGTS - US pipeline) | - | - | 14.00% | 14.00% | 14.00% | - | - | - |
| Rate base (domestic gas distribution) - $ millions | - | - | 1,487 | 1,413 | 1,397 | 1,352 | 1,340 | 1,316 |
| Rate base (domestic gas distribution) - growth | *-0.5%* | - | 5.2% | 1.1% | 3.3% | 0.9% | 1.8% | 7.1% |
| Rate base (TQM - pipeline) - $ millions | - | - | n/a | 493 | 294 | 308 | 307 | 299 |
| Rate base (PNGTS - US pipeline) - US$ millions | - | - | 455 | 450 | 375 | - | - | - |
| Customer/Employee (domestic gas distribution) | *405* | - | 116 | 112 | 113 | 115 | 116 | 107 |
| Customer growth (domestic gas distribution) | *2.6%* | - | 1.7% | 0.8% | -0.3% | 0.0% | 0.0% | 0.1% |
| Degree Day Deficiency - % Normal (domestic gas) | - | - | 87.8% | 84.1% | 86.5% | 98.6% | 99.2% | 92.5% |

* DBRS Industry composite for Canadian gas distributors. Value for average coupon, customers/employee, customer growth and rate base growth is as at December 1999.

(1) Due to a change in accounting policies, income statement data prior to F1998, and in particular coverage ratios, are not directly comparable to prior periods. DBRS estimates that had the accounting changes been adopted sooner, historical coverage ratios would have been weaker than indicated above.

(2) Debt ratios adjusted to reflect receivable sales (i.e., debt equivalent). Minority interest treated as a common equivalent.

(3) Before capitalized interest, AFUDC and debt amortizations. See note (1). R = Revised to conform with F1999 reporting format.

## Gaz Metropolitain and Company, Limited Partnership
**(Consolidated)**

| **Income Statement** ($ millions) | | For years ended September 30 2000 | 1999 | 1998R | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|
| Distribution | | 1,530.4 | 1,248.2 | 1,142.4 | - | - | - | - |
| Transmission | | 58.0 | 42.8 | 29.9 | - | - | - | - |
| Other Energy Services | | 40.4 | 26.9 | 24.2 | - | - | - | - |
| Gross revenues | | 1,628.7 | 1,317.9 | 1,196.5 | 1,205.4 | 1,149.5 | 1,133.5 | 1,228.4 |
| Direct costs | | 1,100.3 | 841.4 | 736.1 | 729.7 | 675.2 | 673.2 | 795.5 |
| Net revenues | | 528.4 | 476.6 | 460.4 | 475.7 | 474.3 | 460.3 | 432.9 |
| Expenses: | | | | | | | | |
| Operating + maintenance | | 176.1 | 160.7 | 155.4 | 150.1 | 144.0 | 149.8 | 144.5 |
| Development costs | | 0.0 | 3.8 | 3.9 | 8.2 | 1.2 | 0.0 | 0.0 |
| Depreciation | | 120.8 | 106.8 | 100.8 | 92.4 | 87.6 | 82.0 | 78.4 |
| Total Operating Costs | | 296.9 | 271.4 | 260.0 | 250.7 | 232.8 | 231.8 | 222.9 |
| Operating income | | 231.5 | 205.2 | 200.4 | 225.0 | 241.5 | 228.5 | 210.0 |
| Interest expense | | 87.7 | 87.1 | 76.2 | 83.4 | 92.2 | 89.5 | 82.3 |
| Other financial charges | | 2.4 | (14.3) | (11.8) | 2.9 | 3.5 | 4.0 | 4.2 |
| Interest/dividend income | | (2.4) | (3.4) | (4.7) | 0.0 | 0.0 | 0.0 | 0.0 |
| Net interest expense | | 87.8 | 69.4 | 59.6 | 86.3 | 95.7 | 93.5 | 86.4 |
| Pre-tax income | | 143.7 | 135.8 | 140.7 | 138.7 | 145.8 | 135.0 | 123.6 |
| | | | | | | | | |
| **Distribution Throughputs - Breakdown** | | | | | | | | |
| Industrial | 60% | 133.8 | 131.5 | 138.3 | 139.7 | 133.2 | 130.2 | 118.9 |
| Commercial | 29% | 64.7 | 60.4 | 55.3 | 60.9 | 59.3 | 54.1 | 58.1 |
| Residential | 11% | 25.6 | 24.3 | 24.2 | 26.5 | 26.7 | 24.1 | 27.4 |
| Total (Actual) - billions of cubic feet | | 224.1 | 216.1 | 217.8 | 227.1 | 219.3 | 208.4 | 204.4 |
| | | | | | | | | |
| **Weather Normalized Throughputs** (Bcf) (2) | | 231.5 | 224.8 | 224.5 | 227.9 | 218.4 | 212.5 | 199.7 |
| | | | | | | | | |
| Growth in volume throughputs (actual) | | 3.7% | -0.7% | -4.1% | 3.6% | 5.2% | 2.0% | 0.6% |
| Growth in volume throughputs (normalized) | | 3.0% | 0.1% | -1.5% | 4.3% | 2.8% | 6.4% | -1.2% |
| | | | | | | | | |
| **Transmission Throughputs** (Bcf) (2) | | 206.7 | 138.7 | 117.7 | 124.8 | 121.3 | 117.0 | n/a |

(1) Domestic distribution revenues are based on weather normalized throughputs.

(2) Volumes not adjusted for Gaz Metro's ownership interest. R = Revised to conform with the F1999 reporting format.