

## Gaz Métro inc.

Report Date: February 25, 2004

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Previous Report: April 8, 2003

## RATING

| Rating    | Trend  | Rating Action | Debt Rated                                | Geneviève Lavallée, CFA/Matthew Kolodzie, CFA, P.Eng.<br>416-593-5577 x2277/x2296<br>glavallee@dors.com |
|-----------|--------|---------------|---|---|
| R-1 (low) | Stable | Confirmed     | Commercial Paper                          |   |
| "A"       | Stable | Confirmed     | First Mortgage Bonds & Other Secured Debt |   |

| RATING HISTORY             | Current   | 2003      | 2002      | 2001      | 2000      | 1999      | 1998      |
|----------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Commercial Paper           | R-1 (low) | R-1 (low) | R-1 (low) | R-1 (low) | R-1 (low) | R-1 (low) | R-1 (low) |
| First Mtg. Bonds/Sec. Debt | "A"       | "A"       | "A"       | "A"       | "A"       | "A"       | "A"       |

## RATING UPDATE

The confirmation of Gaz Métro inc.'s ("Gaz Met" or the "Company") ratings reflects the continuation of relatively stable financial results and the maintenance of the fundamental characteristics underlying the ratings. Gaz Met's earnings for F2003 were essentially unchanged from the previous year with the recording of its share of earnings from its investment in Portland Natural Gas Transmission System ("PNGTS") entirely offset by the negative impact of the lower federal corporate income tax rate because its Canadian-based regulated businesses are permitted to recover current income taxes in its rates, but Gaz Met is not taxable. Therefore, as tax rates decline, Gaz Met's earnings and cash flow decline. Operating cash flows were strong in F2003, due to the colder-than-normal temperatures after five consecutive years of warmer-than-normal temperatures. Despite the strong cash flows, Gaz Met required external financing to fund the significant increase in deferred charges, which are recovered in future rates. The fact that the majority of Gaz Met's operations are regulated and that the regulatory frameworks are relatively favourable provide significant stability to its financial profile. The balance sheet remains reasonable with 61% debt, and key financial ratios

remain relatively strong with fixed-charges coverage at over 2.5 times and cash flow/debt at 25%.

Gaz Met's financial profile is expected to remain stable over the medium term given that regulated businesses are expected to continue to provide the majority of Gaz Met's earnings and cash flows, and that regulation is not expected to change significantly. Gaz Met's increased ownership interest in PNGTS to 38.3% will provide the Company with a boost to earnings and cash flows in F2004. The recent increase in electricity rates in Québec and expectation of further rate increases due to the tightening demand/supply situation is a positive for Gaz Met, as it should improve the competitiveness of natural gas in Québec. A challenge facing Gaz Met is further corporate income tax reductions, although this is not expected to be a significant challenge beyond 2004 given governments' current fiscal positions. The recently renegotiated incentive mechanism agreement for domestic gas distribution operations (although not yet approved by the regulator) is less favourable than the previous agreement, but does not pose a material challenge to Gaz Met's credit rating.

## RATING CONSIDERATIONS

*Strengths:*

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

*Challenges:*

- Under-utilized transmission capacity (PNGTS)
- Competitive pressures from dual energy industrial users, subsidized electricity rates
- Earnings sensitivity to economic cycle and interest rates
- Flow-through tax accounting adversely impacts coverage ratios

## FINANCIAL INFORMATION

For the year ended September 30

|   | 2003  | 2002  | 2001  | 2000  | 1999  |
|---|-------|-------|-------|-------|-------|
| Fixed-charges coverage (times)                | 2.85  | 2.87  | 2.45  | 2.67  | 2.39  |
| % debt in the capital structure (1)           | 61.2% | 61.6% | 62.8% | 61.1% | 59.7% |
| Cash flow/total debt (1)                      | 25.3% | 21.7% | 21.7% | 20.9% | 19.8% |
| Cash flow/capital expenditures (times)        | 3.31  | 3.01  | 3.68  | 3.09  | 1.32  |
| Approved base ROE - domestic gas distribution | 9.89% | 9.67% | 9.60% | 9.72% | 9.64% |
| Net income (bef. extras.) (\$ millions)       | 153.4 | 154.6 | 141.2 | 143.7 | 135.8 |
| Operating cash flow (\$ millions)             | 349.2 | 286.2 | 297.5 | 265.9 | 234.1 |
| Distribution throughputs (Bcf) (2)            | 201.8 | 209.0 | 200.4 | 231.5 | 224.8 |

(1) Debt adjusted to include receivable sales. (2) Weather normalized volumes.

## THE COMPANY

Gaz Métro inc. is the general partner of Gaz Métro Limited Partnership ("GMLP") and currently owns 74.7% of the partnership units. Gaz Métro inc. 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 inc. acts as a financing vehicle for GMLP, raising funds as required and down lending on a back-to-back basis. GMLP is actively involved in gas distribution and transmission.

**AUTHORIZED PAPER LIMIT** Limited to \$300 million.

**GUARANTOR** Gaz Métro Limited Partnership

## Energy

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## BASIS OF ANALYSIS

- The rating of Gaz Met is based on the guarantor, Gaz Métro Limited Partnership (“GMLP”).
- GMLP’s primary investments include:
  - 100% ownership of gas distribution operations in Québec and in Vermont (Northern New England Gas Corporation (“NNEG”));
  - 50% ownership stake in the Trans Québec & Maritimes Pipeline (“TQM”);
  - 100% ownership of a cross-border (Ontario-Québec) pipeline (Champion Pipe Lines); and
- an indirect (held by NNEG) 38.3% ownership interest in a U.S. pipeline, PNGTS, that runs from the Québec/U.S. border to Boston.
- DBRS uses both consolidated and non-consolidated numbers in its analysis.
  - However, given that GMLP’s gas distribution operations in Québec (not a separate subsidiary) make up about 82% of GMLP’s net earnings, the analysis focuses on the consolidated numbers.

## REGULATION

- Domestic gas distribution operations are regulated by the Régie de l’énergie (“Régie”).
- The regulatory framework is a combination of cost of service/rate of return methodology and performance-based regulation (revenue cap).
  - Under the framework, Gaz Met is allowed to retain a share of the productivity gains it generates as a performance incentive.
  - Gas costs continue to be flowed through to the consumer, with price adjustments made on a monthly basis.
- The base approved return on equity (ROE) is determined according to a formula and incorporates a 384 basis point risk premium.
- The formula consists of two components:
  - the August Consensus Forecast yield for ten-year bonds plus the market spread between Government of Canada ten-year and thirty-year bond yields; and
  - 75% of the variance in the August forecast rate of return on 30-year Government of Canada bonds.
- The total approved ROE consists of the base ROE plus the authorized incentive return determined according the following revenue cap formula:
  - $R = (r*(1+i-p))*volumes \pm z$ , where  $r$  = distribution rates,  $i$  = inflation rate,  $p$  = productivity factor and  $z$  = exogenous factors.
- For F2004, the approved base ROE was set at 9.45%, and the authorized incentive return at 1.51% based on forecast productivity gains.
- The approved capital structure for regulatory purposes is 38.5% common equity, 7.5% preferred shares and 54% debt.
- A new incentive mechanism agreement was reached with intervenors and a proposal was filed with the Régie in fall 2003.
  - The new agreement would be a five-year agreement starting October 1, 2004.
- The changes included in the new agreement include:
  - A productivity factor (“p”) of 0.5%, up from 0.3% under the previous agreement;
  - 50/50 sharing of authorized incentive return embedded in the approved ROE compared to a 52.5/47.5 sharing between Gaz Met and customers previously;
  - 25/75 sharing between Gaz Met and customers of productivity gains earned in excess of authorized incentive return compared to 33.3/66.6 sharing between Gaz Met and customers previously; and
  - Maximum upside potential of 375 basis points over base ROE with no off-ramp compared to the previous 400 basis points, with an off-ramp if the Fund earned 400 basis points or more over base ROE for two consecutive years.
- TQM is regulated by the National Energy Board based on a cost of service/rate of return methodology.
  - TQM is also subject to incentive regulation that allows for an equal sharing of cost savings.
  - The current regulatory regime was renewed in 2001 for five years.
  - The approved ROE for 2004 is 9.56% and is renewed annually every December.
- 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 63%.
- PNGTS is regulated by the U.S. Federal Energy Regulatory Commission (FERC). In January 2003, PNGTS received final approval of its general rate case, with key terms retroactive to April 1, 2002. Key items include:
  - A new rate structure effective April 1, 2002, until March 31, 2008;
  - Allowed ROE at 12.5%; and
  - Depreciation rates were reduced to 2% from 4% on transmission and intangible plant assets.
- The new approved rates should result in a return on investment of about 10% at current volume throughputs.

## RATING CONSIDERATIONS

**Strengths:** (1) Regulated operations currently account for essentially all of Gaz Met’s earnings and, thus, provide Gaz Met with a degree of long-term financial stability. 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 during

periods of warmer-than-normal temperatures, but the impact is reversed as deferral balances are recovered.

(2) Gaz Met continues to generate operating cash flows that are more than sufficient to cover its capital expenditures and, in recent years, have been sufficient to fully cover distributions to partners. It is expected that Gaz Met will continue to generate sufficient operating cash flows to internally finance its capital expenditures and distributions to partners absent any large capital projects. However, it is expected that there will continue to be volatility in the level of other investments (namely deferred charges), thus requiring external financing on a periodic basis.

(3) The continued diversification into pipelines, including the recent increased ownership in PNGTS, and into non-regulated activities will reduce Gaz Met's exposure to Québec-based distribution operations.

(4) Gaz Met's key ratios remain strong and compare favourably relative to its peer group. The strength of its financial profile provides Gaz Met with a high degree of financial flexibility.

#### Challenges:

(1) PNGTS is currently operating at only 60% capacity, with current volume throughputs insufficient to generate the authorized rate of return. With the approval of a new rate structure, PNGTS' earnings are expected to improve but increasing volume is key to earnings growth over the longer term. Gaz Met's share of PNGTS' earnings will increase due to the higher ownership interest.

(2) The market penetration of natural gas in Québec 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 the competitive price advantage of gas over alternative sources of fuel. The recent removal of the electricity rate freeze in Québec should improve the competitiveness of natural gas.

(3) Gaz Met's earnings and cash flows are sensitive to the economic cycle and to interest rates through approved ROEs. About 60% of gas volumes are delivered to industrial customers, who are sensitive to economic conditions. In terms of interest rates, a 25 basis point change in approved ROEs would impact net earnings by about \$2.25 million. In addition, Gaz Met's cash flows are very sensitive to changes in weather from one year to the next given that the remaining 40% of volumes are delivered to commercial and residential customers. These factors affect earnings and cash flow over the medium term, but are less of an issue over the long term.

(4) Gaz Met faces contingent liabilities for TQM 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 Met.

(5) The use of the flow-through method of accounting for income taxes (standard practice in Canada) adversely impacts coverage ratios and has resulted in an unrecorded deferred income tax liability of \$117.6 million as at September 2003. The recovery of this liability in future rates is not assured. The flow-through method results in lower revenue collections, thereby reducing operating income, interest coverage ratios and given that Gaz Met is not taxable, net income as well.

### **EARNINGS AND OUTLOOK**

| Consolidated results for GM LP<br>(\$ millions)  | For the year ended September 30 |                                 |       |       |       |       |
|--|---------------------------------|---------------------------------|-------|-------|-------|-------|
|  | 2003                            | 2002                            | 2001  | 2000  | 1999  |       |
| Net revenues                                     | 562.7                           | 546.2                           | 531.0 | 526.5 | 476.6 |       |
| EBITDA   | 369.1                           | 369.5                           | 363.5 | 350.4 | 312.0 |       |
| EBIT   | 237.2                           | 234.3                           | 236.4 | 229.6 | 205.2 |       |
| Gross interest expense                           | 84.6                            | 83.1                            | 97.7  | 87.7  | 87.1  |       |
| Net interest expense                             | 83.8                            | 79.7                            | 95.2  | 85.9  | 69.4  |       |
| Net income                                       | 153.4                           | 154.6                           | 141.2 | 143.7 | 135.8 |       |
| <b>Segmented Earnings</b>                        | %                               | For the year ended September 30 |       |       |       |       |
| Operating income                                 |                                 | 2003                            | 2002  | 2001  | 2000  | 1999  |
| Distribution                                     | 84%                             | 199.7                           | 202.1 | 205.7 | 198.1 | 181.7 |
| Transmission                                     | 15%                             | 35.4                            | 30.4  | 32.2  | 32.1  | 22.4  |
| Energy services & other (incl. unallocated)      | 1%                              | 2.0                             | 1.9   | (1.5) | (0.6) | 1.0   |
| Operating income (EBIT)                          | 100%                            | 237.2                           | 234.3 | 236.4 | 229.6 | 205.2 |
| Net income                                       |                                 |                                 |       |       |       |       |
| Distribution                                     | 90%                             | 138.0                           | 142.1 | 134.6 | 135.2 | 124.9 |
| Transmission                                     | 11%                             | 16.6                            | 12.8  | 10.3  | 12.0  | 12.1  |
| Energy services & other (incl. unallocated)      | -1%                             | (1.3)                           | (0.3) | (3.7) | (3.5) | (1.2) |
| Net income                                       | 100%                            | 153.3                           | 154.6 | 141.2 | 143.7 | 135.8 |
| Weather normlized distribution throughputs (Bcf) |                                 | 201.8                           | 209.0 | 200.4 | 231.5 | 224.8 |
| Transportation throughputs (Bcf)                 |                                 | 223.1                           | 227.3 | 212.6 | 206.7 | 138.7 |

**Summary:**

- Both EBIT and net income were essentially unchanged in F2003.
- The increased earnings from gas transmission due to the recording of Gaz Met's share of PNGTS' income was offset by the decline in gas distribution's earnings due to the reduction in the federal corporate income tax rate.
  - The two percentage point reduction in the corporate income tax rate reduced revenues and income by a total of \$4.6 million in F2003 (\$4.2 million for gas distribution and \$0.4 million

for TQM) – this represents a 3% reduction in net income, which is not insignificant.

- Gaz Met is permitted to recover current income taxes in the rates on its Canadian-based regulated businesses but these businesses are not taxable; therefore, any change in corporate tax rates directly impacts net income.

**Outlook:**

- The medium-term outlook for Gaz Met's earnings remains favourable, although growth will likely remain modest.
- Earnings from the gas distribution segment should benefit from the rising electricity rates in Québec, thus improving the competitiveness of natural gas.
- Earnings from the gas transmission segment will benefit from Gaz Met's increased ownership of PNGTS, now at 38.3% as at November 17, 2003.
  - The approval of new rates for PNGTS for the period covering April 1, 2002, to March 31, 2008, also provides increased income certainty over the medium term.
- Earnings in 2004 will be negatively impacted by a further two percentage point reduction in the corporate income tax rate, expected to reduce income by another \$4.6 million.
  - Further federal/provincial tax cuts over the medium term remains a risk for Gaz Met's earnings profile

although the risk is considered minimal given the current fiscal position of both the federal and provincial governments.

- Over the longer term, Gaz Met should record some earnings growth from its non-regulated activities, as well as from some of the various quasi-regulated projects currently under consideration, including:
  - Investment in new cogeneration plants in Québec, where electricity demand/supply conditions are beginning to tighten;
  - Investment in the recovery of landfill gas in Québec; and
  - Investment in a liquid natural gas terminal near Québec City.

**FINANCIAL PROFILE AND SENSITIVITY ANALYSIS**

| (\$ millions)                                  | For the year ended September 30 |         |         | Sensitivity Analysis |         |         |
|--|---------------------------------|---------|---------|----------------------|---------|---------|
|  | 2003                            | 2002    | 2001    | Year 1               | Year 2  | Year 3  |
| <b>EBITDA</b>                                  | 369.1                           | 369.5   | 363.5   | 332.2                | 332.2   | 332.2   |
| Net income                                     | 153.4                           | 154.6   | 141.2   | 105.9                | 104.1   | 104.1   |
| Depreciation + amortization of def. charges    | 134.8                           | 136.3   | 128.3   | 135.5                | 136.7   | 136.9   |
| Rate stabilization                             | 11.7                            | (50.5)  | (5.3)   | 0.0                  | 0.0     | 0.0     |
| Reduction in def. charges related to gas costs | 49.3                            | 45.8    | 33.3    | 0.0                  | 0.0     | 0.0     |
| <b>Operating Cash Flow</b>                     | 349.2                           | 286.2   | 297.5   | 241.4                | 240.8   | 240.9   |
| Capital expenditures                           | (105.7)                         | (95.0)  | (80.8)  | (100.0)              | (100.0) | (100.0) |
| Cash flow before working capital changes       | 243.6                           | 191.3   | 216.6   | 141.4                | 140.8   | 140.9   |
| Working capital changes                        | (50.2)                          | 12.6    | 25.6    | 0.0                  | 0.0     | 0.0     |
| Free cash flow before distributions            | 193.4                           | 203.9   | 242.2   | 141.4                | 140.8   | 140.9   |
| Distributions to Partners                      | (148.0)                         | (141.4) | (140.3) | (100.6)              | (98.9)  | (98.8)  |
| Free cash flow after distributions             | 45.3                            | 62.5    | 101.9   | 40.8                 | 41.9    | 42.1    |
| Net investments & deferred charges             | (155.3)                         | (16.4)  | (177.1) | (60.0)               | (40.0)  | (40.0)  |
| Net debt financing                             | 42.5                            | (39.2)  | 73.9    | 9.2                  | (1.9)   | (2.1)   |
| Net equity financing                           | 66.7                            | 0.0     | 0.9     | 10.0                 | 0.0     | 0.0     |
| Net change in cash                             | (0.7)                           | 6.9     | (0.4)   | 0.0                  | 0.0     | (0.0)   |
| Cash flow/capital expenditures (times)         | 3.31                            | 3.01    | 3.68    | 2.41                 | 2.41    | 2.41    |
| Cash flow/total debt (times) (1)               | 25.3%                           | 21.7%   | 21.7%   | 17.4%                | 17.4%   | 17.4%   |
| % debt in the capital structure (1)            | 61.2%                           | 61.6%   | 62.8%   | 60.9%                | 60.7%   | 60.6%   |
| Fixed-charges coverage (times)                 | 2.85                            | 2.87    | 2.45    | 2.17                 | 2.15    | 2.15    |

(1) Receivable sales treated as short-term debt financings.

### Summary:

- Operating cash flows increased significantly in F2003 due to the colder-than-normal weather compared to the previous five years when the weather was warmer than normal.
  - Operating cash flows are more volatile than earnings from year-to-year due to the weather-related rate stabilization mechanism that smoothes the earnings impact of weather-induced gas consumption fluctuations.
- The increased operating cash flows resulted in another free cash flow surplus, which was used to partially fund the large increase in deferred charges due to the high natural gas prices.
  - Remainder of financing requirements met through a combination of both debt and equity issuance.
  - As a result, Gaz Met's capital structure remained stable.
- Given the dominance of regulated activities, Gaz Met's leverage and fixed-charges coverage ratio tend to fluctuate within a narrow band.
- However, its cash flows and deferred charges, which include natural gas costs, tend to be more volatile given the volatility of both weather and natural gas prices.

### Outlook:

- Operating cash flows will remain more volatile than earnings and continue to track the volatility in weather from one year to the next.
- Over the medium term, however, operating cash flows should generally grow in line with the expected modest earnings growth.
  - Gaz Met should receive a boost in operating cash flows in F2004 from its increased ownership interest in PNGTS.
- Operating cash flows will remain sufficient to cover Gaz Met's capital expenditures and distributions to partners, assuming no large acquisitions.
  - Annual capital expenditures are expected to remain around \$100 million.
- However, other investments (including deferred charges) will remain more volatile given that they include natural gas costs.
  - Deferred charges are recovered in future rates, but often require external financing in the meantime.
- Over the longer term, key financial ratios should remain in line with current levels given that the majority of Gaz Met's assets are regulated.
- Gaz Met's financial profile is expected to remain within the acceptable range for the rating given its business risk profile.

### Sensitivity Analysis:

DBRS stress tests the financial strength of companies analyzed to measure their sensitivity under various extreme scenarios. The assumptions used are based neither upon any specific information provided by the Company, nor any expectations that DBRS has concerning the future performance of the Company.

#### Assumptions:

- EBITDA declines 10% in Year 1 and remains flat thereafter.
- Capital expenditures are \$100 million per year and other investments are \$60 million in Year 1 and \$40 million per year thereafter.
- The distributions payout is 95% of net income.
- Equity financing of \$10 million in Year 1 (given the issue done in October 2003), and \$0 thereafter.
- Any free cash flow deficit is debt financed.

#### Outcomes:

- Despite the decline in EBITDA, Gaz Met would continue to record free cash flow surpluses, and would have to borrow only minimal amounts to fund its other investments (namely deferred charges).
- Although some of its key ratios would deteriorate, Gaz Met's financial profile would remain acceptable for the rating.

## LONG-TERM DEBT MATURITIES AND BANK LINES

### Debt maturities and sinking fund requirements

As at September 30, 2003

| (\$ millions)                   | <u>F2004</u> | <u>F2005</u> | <u>F2006</u> | <u>F2007</u> | <u>F2008</u> |
|---------------------------------|--------------|--------------|--------------|--------------|--------------|
| First mortgage bonds/term loans | 16.7         | 52.1         | 82.5         | 80.6         | 5.6          |

### Summary:

- Gaz Met's debt maturities are reasonably well spread and should not present any liquidity problems.
  - Subsequent to its year-end, Gaz Met issued \$125 million, 30-year first mortgage bonds.
  - The proceeds were used to cover working capital requirements and term out a portion of its commercial paper outstanding.
- Gaz Met currently has a \$300 million commercial paper program that is backed by a fully committed term bank facility maturing in April 2005.
  - As at December 31, 2003, Gaz Met had \$178 million outstanding under its commercial paper program.

- Other credit facilities include:
  - Gaz Met’s \$143 million, unsecured 364-day renewable line of credit;
  - Gaz Met’s share of TQM’s unsecured 364-day renewable line of credit is \$10 million; and
  - Vermont Gas Systems’ unsecured bank lines totalling US\$22.5 million.
- As at September 30, 2003, the total amount outstanding under the above-mentioned credit facilities was \$30.8 million.

**Gaz Metro Limited Partnership**  
(Consolidated)

**Balance Sheet**

(\$ millions)

|                         | As at September 30 |                |                |                                 | As at September 30 |                |                |
|-------------------------|--------------------|----------------|----------------|---------------------------------|--------------------|----------------|----------------|
|                         | 2003               | 2002           | 2001           |                                 | 2003               | 2002           | 2001           |
| <b>Assets</b>           |                    |                |                | <b>Liabilities &amp; Equity</b> |                    |                |                |
| Cash                    | 9.8                | 10.6           | 3.7            | Short-term debt                 | 30.8               | 29.9           | 38.4           |
| Accounts receivable     | 41.7               | 35.9           | 32.8           | A/P + accr'ds.                  | 235.8              | 243.5          | 229.1          |
| Inventories             | 251.8              | 216.3          | 216.5          | L.t.d. due in one year          | 16.7               | 44.4           | 3.1            |
| Prepaid expenses        | 5.4                | 6.5            | 6.4            | <b>Current Liabilities</b>      | 283.3              | 317.7          | 270.6          |
| <b>Current Assets</b>   | 308.7              | 269.4          | 259.4          | Long-term debt (1)              | 1,271.9            | 1,196.8        | 1,267.2        |
| Net fixed assets        | 1,786.2            | 1,758.7        | 1,750.7        | Minority interest               | 0.0                | 0.0            | 0.0            |
| Rate stabilization acct | 76.2               | 105.6          | 70.8           | Partners' equity                | 876.0              | 822.7          | 811.8          |
| Deferred + other assets | 236.8              | 180.4          | 244.8          |                                 |                    |                |                |
| Goodwill                | 23.4               | 23.1           | 24.0           |                                 |                    |                |                |
| <b>Total</b>            | <b>2,431.2</b>     | <b>2,337.2</b> | <b>2,349.7</b> | <b>Total</b>                    | <b>2,431.2</b>     | <b>2,337.2</b> | <b>2,349.7</b> |

**Ratio Analysis**
**Liquidity Ratios (2)**

|  | <u>Non-consolidated basis</u> |       |       | <u>Consolidated basis</u>       |       |       |       |       |
|--|-------------------------------|-------|-------|---------------------------------|-------|-------|-------|-------|
|  | For years ended September 30  |       |       | For the year ended September 30 |       |       |       |       |
|  | 2003                          | 2002  | 2001  | 2003                            | 2002  | 2001  | 2000  | 1999  |
| Current ratio                                    | 1.22                          | 1.00  | 1.05  | 1.07                            | 0.87  | 0.97  | 1.09  | 0.80  |
| Accumulated depreciation/gross fixed assets      | 34.9%                         | 33.6% | 32.2% | 34.3%                           | 33.3% | 31.5% | 29.7% | 27.9% |
| Cash flow/total debt                             | 30.5%                         | 25.8% | 26.3% | 25.3%                           | 21.7% | 21.7% | 20.9% | 19.8% |
| Cash flow/capital expenditures                   | 3.84                          | 3.31  | 4.14  | 3.31                            | 3.01  | 3.68  | 3.09  | 1.32  |
| Cash flow-distributions/capital expenditures     | 2.05                          | 1.47  | 1.97  | 1.90                            | 1.53  | 1.94  | 1.50  | 0.56  |
| % debt in capital structure                      | 54.3%                         | 54.6% | 55.7% | 61.2%                           | 61.6% | 62.8% | 61.1% | 59.7% |
| Average coupon on long-term debt                 | 8.39%                         | 8.41% | 8.42% | 7.96%                           | 7.96% | 7.96% | 7.65% | 8.05% |
| Deemed common equity (domestic gas distribution) | 38.5%                         | 38.5% | 38.5% | 38.5%                           | 38.5% | 38.5% | 38.5% | 38.5% |
| Deemed common equity (U.S. gas distribution)     | 63.3%                         | 63.3% | 63.3% | 63.3%                           | 63.3% | 63.3% | 63.3% | 63.3% |
| Deemed common equity (TQM - pipeline)            | 30.0%                         | 30.0% | 30.0% | 30.0%                           | 30.0% | 30.0% | 30.0% | 30.0% |
| Deemed common equity (PNGTS - U.S. pipeline)     | 25.0%                         | 25.0% | 25.0% | 25.0%                           | 25.0% | 25.0% | 25.0% | 25.0% |
| Distribution payout (before extras.)             | 96.5%                         | 91.5% | 99.4% | 96.5%                           | 91.5% | 99.4% | 95.3% | 99.2% |

**Coverage Ratios (3)**

|                          |      |      |      |      |      |      |      |      |
|--------------------------|------|------|------|------|------|------|------|------|
| EBIT interest coverage   | 3.18 | 3.42 | 2.92 | 2.85 | 2.87 | 2.45 | 2.67 | 2.39 |
| EBITDA interest coverage | 4.85 | 5.06 | 4.31 | 4.41 | 4.50 | 3.75 | 4.04 | 3.62 |
| Fixed charges coverage   | 3.18 | 3.42 | 2.92 | 2.85 | 2.87 | 2.45 | 2.67 | 2.39 |

**Earnings Quality/Operating Efficiencies & Statistics**

|   |       |       |       |          |          |          |          |          |
|---|-------|-------|-------|----------|----------|----------|----------|----------|
| Operating margin                                    | 43.6% | 45.9% | 46.7% | 42.2%    | 42.9%    | 44.5%    | 43.6%    | 43.1%    |
| Net margin (before extras.)                         | 34.3% | 34.9% | 33.2% | 27.3%    | 28.3%    | 26.6%    | 27.3%    | 28.5%    |
| Return on partners equity (before extras./pre-tax)  | 18.1% | 18.9% | 17.5% | 18.1%    | 18.9%    | 17.5%    | 17.9%    | 17.7%    |
| Approved base ROE (domestic gas distribution)       | -     | -     | -     | 9.89%    | 9.67%    | 9.60%    | 9.72%    | 9.64%    |
| Approved total ROE (domestic gas distribution)      | -     | -     | -     | 10.34%   | 9.69%    | 10.38%   | 9.72%    | 9.64%    |
| Approved ROE (U.S. gas distribution)                | -     | -     | -     | 11.25%   | 11.25%   | 11.25%   | 11.25%   | 11.25%   |
| Approved ROE (TQM - pipeline)                       | -     | -     | -     | 9.79%    | 9.53%    | 9.61%    | 9.90%    | 9.58%    |
| Approved ROE (PNGTS - U.S. pipeline)                | -     | -     | -     | 12.50%   | 12.50%   | 14.00%   | 14.00%   | 14.00%   |
| Rate base - domestic gas distribution (\$ millions) | -     | -     | -     | 1,566.71 | 1,545.60 | 1,545.84 | 1,487.00 | 1,413.25 |
| Rate base growth - domestic gas distribution        | -     | -     | -     | 1.4%     | 0.0%     | 4.0%     | 5.2%     | 1.1%     |
| Rate base (avg.) - TQM pipeline (\$ millions)       | -     | -     | -     | 484.51   | 504.14   | 524.17   | 544.07   | 492.70   |
| Customer/employee (domestic gas distribution)       | -     | -     | -     | 122.36   | 127.78   | 127.68   | 115.95   | 112.44   |
| Customer growth (domestic gas distribution)         | -     | -     | -     | 0.7%     | 1.1%     | 0.1%     | 1.7%     | 0.8%     |
| Degree day deficiency - % normal (domestic gas)     | -     | -     | -     | 106.4%   | 81.7%    | 99.9%    | 87.8%    | 84.1%    |

(1) Long-term debt includes commercial paper outstanding.

(2) Debt ratios adjusted to reflect receivable sales (i.e., debt equivalent).

(3) Before capitalized interest, AFUDC and debt amortizations. See note (1).

