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Principal Credit Drivers for the Natural Gas Industry: A Rating Agency Perspective

Michael Messer
Director
Standard & Poor's Ratings Services
October 10, 2007

Régie de l'énergie

DOSSIER: R-3807-2012

DÉPOSÉE EN AUDIENCE

Date: 23/01/2013

Pièces n°: B-0047

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Agenda

- **What is a Credit Rating?**
- **Analytical Process and the Role of Business Risk**
- **Consolidated Ratings Methodology**
- **Rating Trends for Natural Gas LDCs**
- **Regulation and other Key Business Risk Drivers**

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What is a Credit Rating?

A Credit Rating Represents an Independent Opinion Regarding ...

- Likelihood that an issuer will default on its financial obligations
- Capacity and willingness to pay principal and interest in accordance with the terms of its debt obligations
- Forward-looking opinion based on qualitative factors and quantitative data

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What is A Credit Rating?

It Is Not a Recommendation to Buy, Sell or Hold a Security...

It Is Not an Audit of Obligors' Financial Statements...

It is Not Intended To Stimulate Any Market Or Investor Response!

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How Do Our Ratings Add Value?

Intermediaries (Bankers)

- Facilitates pricing against other benchmark deals
- Provides an independent opinion on the credit of their own clients

Issuers (Borrowers)

- “Ticket of Admission” to many debt markets
- Planning tool for cost of debt
- Expansion of potential investor universe
- Measure of comparison

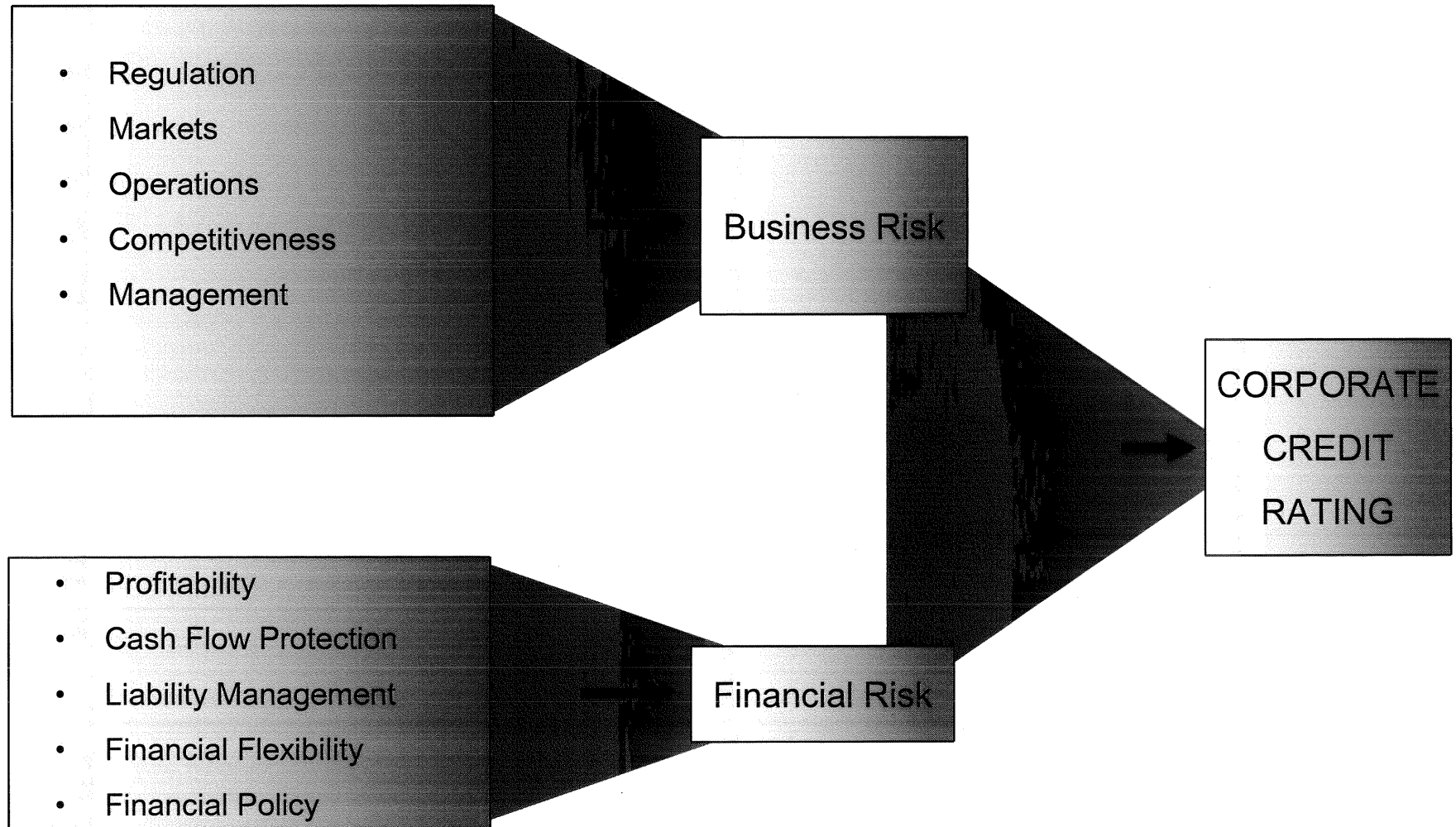
Investors (Lenders)

- Can “benchmark” credit against other issues
- Supplements in-house credit resources

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The Analytical Process: Deriving the Corporate Credit Rating

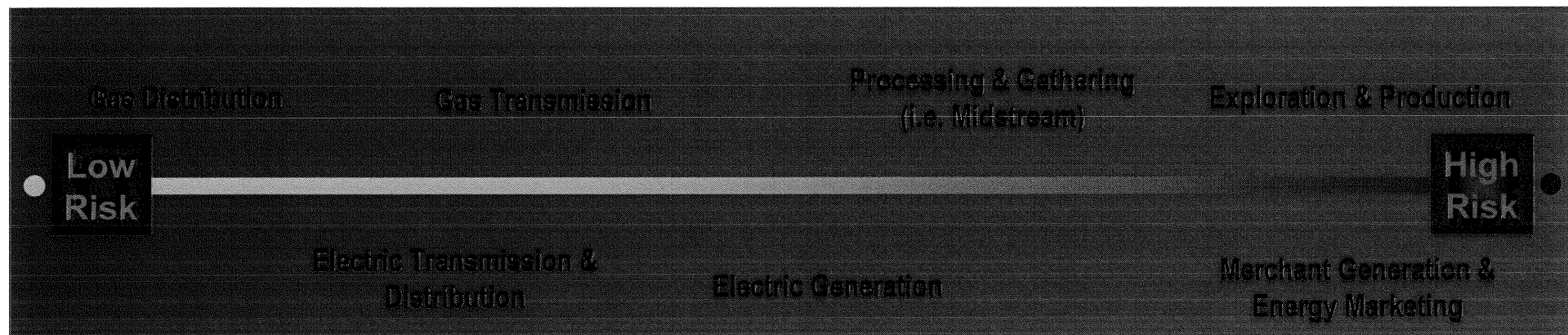


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Gas Industry Risk Spectrum vs. Electric Utilities



AGL Resources Inc.
 Alabama Gas Corp.
 Atlanta Gas Light Co.
 Atmos Energy Corp.
 Bay State Gas Co.
 Boston Gas Co.
 Colonial Gas Co.
 Equitable Resources Inc.
 Indiana Gas Co. Inc.
 KeySpan Corp.
 KeySpan Energy Delivery Long Island
 KeySpan Energy Delivery New York
 Laclede Gas Co.
 Laclede Group Inc. (The)
 National Fuel Gas Co.
 New Jersey Natural Gas Co.

A-/Negative/A-2
 BBB+/Stable/--
 A-/Negative/--
 BBB/Positive/A-2
 BBB/Stable/--
 A-/Stable/--
 A-/Stable/--
 A-/Watch Neg/A-2
 A-/Stable/--
 A-/Stable/A-2
 A/Stable/--
 A/Stable/--
 A/Stable/A-1
 A/Stable/--
 BBB+/Stable/A-2
 A+/Negative/A-2

Nicor Gas Co.
 NiSource Inc.
 Northern Indiana Public Service Co.
 Northwest Natural Gas Co.
 Piedmont Natural Gas Co. Inc.
 Questar Gas Co.
 SEMCO Energy Inc.
 Source Gas LLC
 South Jersey Gas Co.
 Southern California Gas Co.
 Southern Indiana Gas & Electric Co.
 Southwest Gas Corp.
 Vectren Corp.
 Washington Gas Light Co.
 WGL Holdings

AA/Negative/A-1+
 BBB/Stable/--
 BBB/Stable/--
 AA-/Stable/A-1+
 A/Stable/--
 A-/Stable/--
 BB-/Positive/--
 BBB-/Stable/--
 BBB+/Stable/--
 A/Stable/A-1
 A-/Stable/--
 BBB-/Positive/--
 A-/Stable/--
 AA-/Stable/A-1
 AA-/Stable/A-1

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Consolidated Ratings Methodology

- **Parent and subsidiary generally equalized at a “consolidated” rating based on business and financial profile of all related business lines**
 - Cash is flexible & fungible
 - Regulated (i.e. lower risk) businesses may subsidize other unregulated units (i.e. higher risk) cash requirements
 - Company’s ability to meet its obligations is generally the same throughout the organization

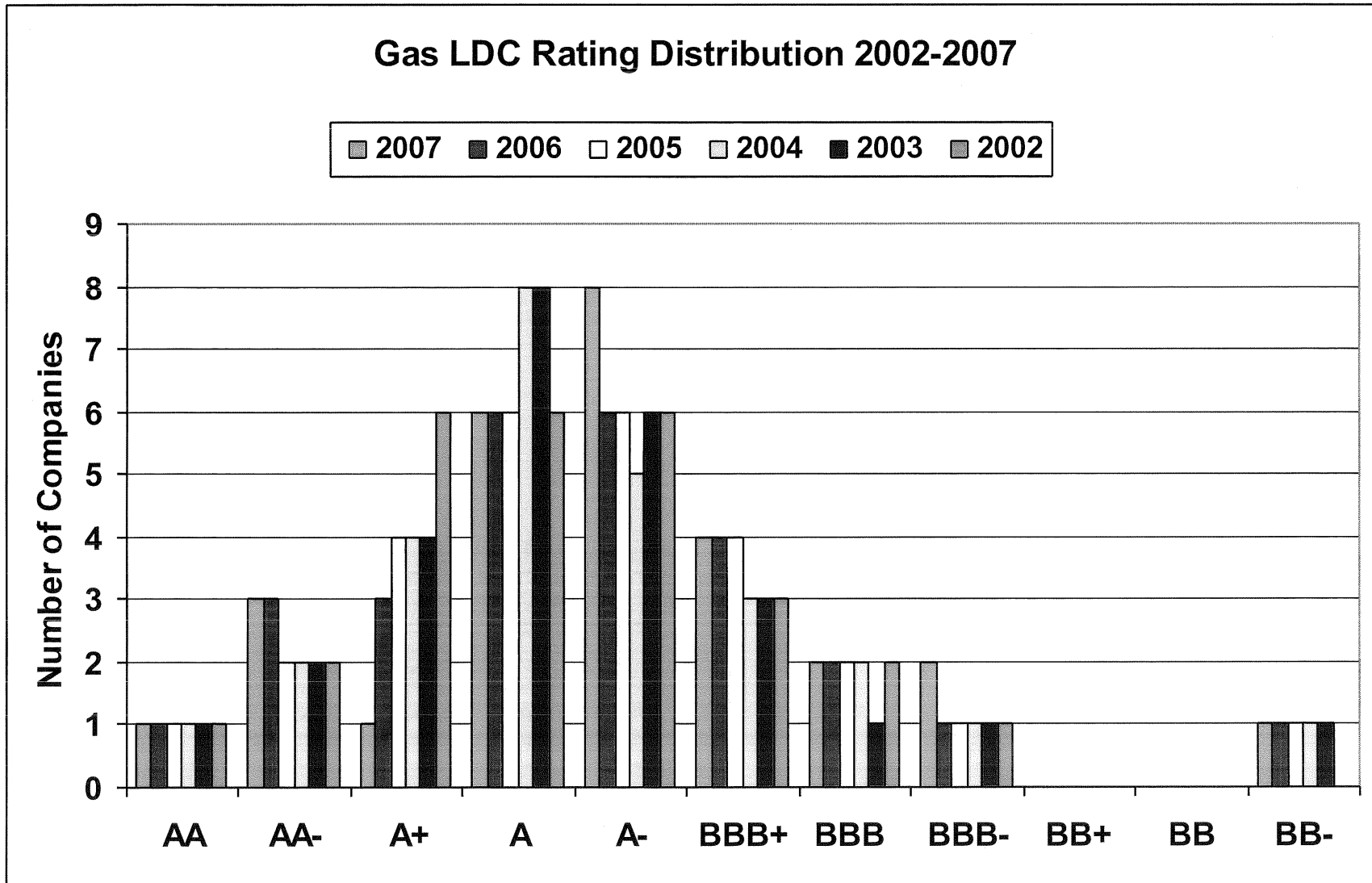
- **Ring-fencing may allow ratings to be elevated above the parent rating**
 - Regulation must be proactive and impose dividend limitations prior to financial distress
 - Mandated leverage and coverage at meaningfully supportive levels
 - Legal separation with independent governance
 - Economic disincentives

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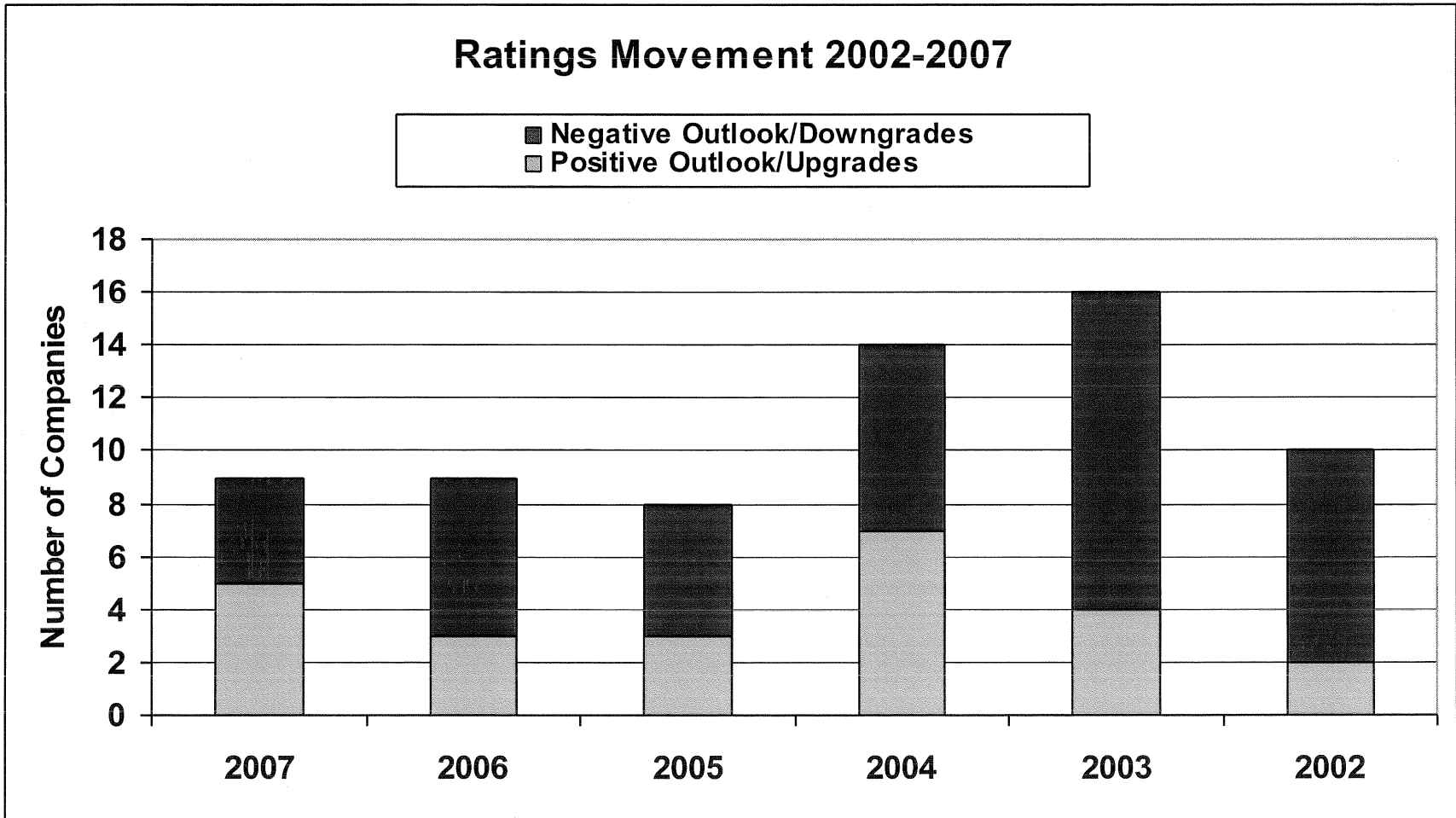
Gas Distribution Has Solid Investment Grade Profile



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Positive Ratings Momentum in Gas LDC Ratings in 2007



Ratings data includes upgrades/downgrades and positive/negative/CreditWatch outlook changes

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The Importance of Regulation

➤ Without Regulation, Industry Would Not Support Same Leverage

Debt Leverage Medians/ Averages By Sector (2004 to 2006)

Debt Leverage -- Total Debt/ Total Debt + Equity (%)

| | AA | A | BBB |
|--|------|------|------|
| Industrial Companies (Excluding Utilities) | 36.1 | 38.4 | 43.7 |
| Utility Companies | 55.6 | 54.3 | 56.5 |

➤ Regulation...

- Provides A Level Of Support During Periods Of Stress
- Allows Deferral Of Costs For Later Recovery
- Provides The Opportunity To Earn A Set Return On Assets And To Maintain Financial Strength Regardless Of Economic Or Financial Environment

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Business Risk Drivers for Gas Distribution Utilities

- **Regulation:**

- Adequacy and timeliness of cost recovery
- Use of forward looking measures or cost pass-through mechanisms
- Rate structures that provide keep utilities neutral to weather-related volatility and increasing conservation
- Performance based rate plans

- **Markets:**

- Proportion of more stable, higher margin residential and commercial customers versus industrial load
- Population growth in the service territory
- Income levels relative to national averages to support cost pass-through

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Business Attributes of Gas Utilities (cont'd)

- **Operations:**

- Reliability of gas delivery system
- Well diversified gas supply sources with creditworthy counterparties
- Adequate storage and peaking capacity relative to design day requirements
- Cost controls (O&M per customer; Cost per new meter)

- **Competitive Position:**

- Rate competitiveness vs. regional competition
- Impact of retail competition (if any) for competitively bid loads

- **Non-regulated operations**

- Retail (moderate risk) versus wholesale marketing (moderate to high risk)
- Risk management policies and controls
- Liquidity requirements

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Credit Issues for 2008

- Revenue/weather-normalized rate designs suggest lower future ROEs
- Rate pressure from rising commodity and capital costs
- Increasing interest and exposure to unregulated gas storage assets

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