

Research

Summary:

Gaz Metro inc. Gaz Metro L.P.

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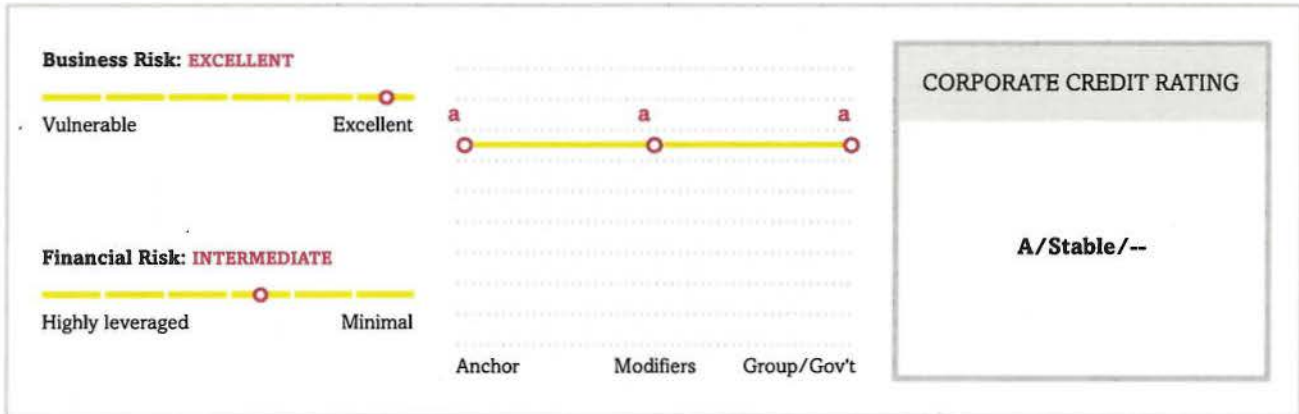
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Summary:

**Gaz Metro inc.
Gaz Metro L.P.**



Rationale

Business Risk: Excellent	Financial Risk: Intermediate
<ul style="list-style-type: none"> • Supportive regulatory environment in Quebec and diversity of regulated operations provide stable cash flows • Dependence on industrial consumption in Quebec introduces higher volume variability than predominantly residential distributors 	<ul style="list-style-type: none"> • Financial metrics reflect the regulated capital structure as well as additional debt at the L.P. level • Standard & Poor's Ratings Services expects financial metrics to remain stable over its two-year outlook period

Outlook: Stable

The stable outlook reflects our expectations in the next two years of continued regulatory support in Quebec and Vermont, of some modest synergies from the combination of Central Vermont Power Service and Green Mountain Power Corp. operations, and that Gaz Metro inc. (GMi) will sustain adjusted funds from operations (AFFO)-to-debt of 13%-23% (consolidated and deconsolidated). We also expect adjusted debt-to-capital to remain below 70%, consistent with the regulatory capital structure and trust indenture limits.

Upside scenario

An outlook revision to positive or an upgrade is not likely without a demonstrated, long-term commitment to a much stronger balance sheet with stronger cash flow metrics (23% AFFO-to-total debt or better).

Downside scenario

A downgrade is possible if the company fails to keep consolidated AFFO-to-debt above 16%, which we would expect would be as a result of material nonregulatory debt that finances acquisitions. We believe material changes to the business risk profile resulting in an outlook revision are unlikely, given trust indentures that limit the amount of nonregulatory business contribution to the consolidated entity. Although we don't expect it, any adverse material developments (such as an adverse regulatory decision or additional debt-financed acquisitions) could change our view on the company's business risk and financial risk profiles.

Standard & Poor's Base-Case Scenario

Assumptions	Key Metrics			
<ul style="list-style-type: none"> • FFO of C\$530 million-C\$550 million in 2015, with about 70% from Quebec and 20% from Vermont, with the remainder from equity interests in other entities • A cost-of-service methodology for the Quebec gas distribution in 2014, with a return to incentive mechanisms in 2015 	2013A	2014E	2015E	
	AFFO/debt	15.8	18%-19%	19%-20%
	Debt/EBITDA	5.8	4.0x-5.0x	4.0x-5.0x

AFFO--Adjusted funds from operations. A--Actual.
E--Estimate.

Business Risk: Excellent

We believe that Gaz Metro has an "excellent" business risk profile, reflecting our opinion of the company's monopoly position of its core gas distribution and supportive regulatory environment in Quebec, diversification through its wholly owned subsidiary Green Mountain Power, and the consistency of earnings and credit metrics. Offsetting these

factors is our assessment of the low organic growth in Gaz Metro's jurisdictions and a high degree of dependence on industrial natural gas volumes in Quebec, which has a higher degree of variability than residential consumption.

Financial Risk: Intermediate

We believe that Gaz Metro has an "intermediate" financial risk profile. Financial metrics reflect a high degree of leverage associated with the regulated capital structure, as well as additional debt at the GMLP level. We forecast financial metrics to improve to the 18%-20% funds from operations (FFO)-to-debt range in 2014-2015.

Combining our business and financial risk assessments, we arrive at an 'a' anchor score.

Liquidity: Adequate

We view GMI's liquidity to be "adequate," with sources less uses being positive and sources over uses to exceed 1.2x during the next 12 months. We believe the company will continue to have solid relationships with its banks and a generally high standing in credit markets with prudent risk management.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none">• FFO of C\$430 million-C\$450 million• Revolver availability of C\$480 million-C\$500 million	<ul style="list-style-type: none">• Capex of C\$600 million-C\$650 million• Dividends of C\$190 million-C\$210 million

Other Modifiers

We applied no modifiers in arriving at our final 'A' corporate credit rating.

Ratings Score Snapshot

Corporate Credit Rating

A/Stable/--

Business risk: Excellent

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Excellent

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: a

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Financial policy:** Negative (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Recovery Analysis

GMI has secured utility bonds (first mortgage bonds [FMBs]) outstanding with maturities of 2017-2036. These FMBs are secured under a trust deed that contains a hypothec on GMI's Quebec property. A first immovable hypothec on Green Mountain's pipelines and gas distribution system also covers creditors. We estimate that the regulated capital value at Gaz Metro is greater than 1.5x the secured utility bonds outstanding. This results in a '1+' recovery rating, and an 'A+' rating on the FMBs.

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- 2008 Corporate Criteria: Commercial Paper, April 15, 2008
- Standard & Poor's Canadian CP Ratings: An Overview, March 30, 2006

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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