

*Énergir, s.e.c*  
*Gazifère Inc.*  
*Intragaz, s.e.c.*

*Demande conjointe relative à la fixation de taux de rendement  
et de structures de capital, R-4156-2021*

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**R A P P O R T D E C R É D I T : S & P G L O B A L 2 0 1 8**

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**Research Update:**

## **Energir Inc. And Energir L.P. Ratings Affirmed, Outlook Stable; First-Mortgage Bond Rating Lowered To 'A'**

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## Research Update:

# Energir Inc. And Energir L.P. Ratings Affirmed, Outlook Stable; First-Mortgage Bond Rating Lowered To 'A'

## Rating Action Overview

- On Dec. 17, 2018, S&P Global Ratings affirmed its 'A' long-term issuer credit rating on Quebec-based regulated utility Energir Inc. (Energir) and Energir L.P.
- We also affirmed our 'A-1' global scale and 'A-1 (Mid)' Canada scale commercial paper ratings on Energir.
- At the same time, we revised our recovery rating on Energir's senior secured first-mortgage bonds (FMBs) to '1' from '1+', resulting in a one-notch ratings downgrade on the company's FMBs to 'A' from 'A+'.
- The recovery rating revision on the FMBs reflects our diminished but still very high confidence of full recovery on the company's secured bonds, stemming from significant collateralization between 1x-1.5x, versus our previous assessment that corresponded with our highest level confidence for full recovery.
- The stable outlook reflects our view that the company will continue to generate predictable and stable cash flows from its low-risk, regulated gas and electricity businesses in Quebec and Vermont.

## Rating Action Rationale

The revision of Energir Inc.'s FMB recovery rating reflects our very high confidence of full recovery on the company's senior FMBs with significant collateralization between 1x-1.5x, versus our previous assessment which showed our highest level of confidence for full recovery. This reflects our use of the utility's regulated capital value (RCV), typically net property plant and equipment, as an estimate of the value of the collateral available to the senior secured bondholders to satisfy claims in a bankruptcy proceeding. Our 'A' issuer credit rating (ICR) on Energir, together with our '1' recovery rating results in an 'A' rating for the company's secured FMBs.

Our ratings affirmations reflect our views of the company's business and financial risks, which are unchanged and appropriate for current rating on the company. From a business risk perspective, Energir continues to benefit from its stable, low-risk, regulated utilities operations. Tariff structures are generally supportive, allowing for recovery of prudently incurred operational and capital expenses in a timely manner, which supports stable cash flows. Moreover, the company's exposure to commodity input prices is limited because

electricity and natural gas input costs remain a pass-through to ratepayers, which we view as favorable for the company's credit quality.

In Quebec, where distribution activities account for about 65% of net income, Energir can recover revenue shortfalls from weather-related events in subsequent years, which reduces its sales volume risk exposure. Furthermore, key rate-base parameters such as return on equity and equity layer that Regie de l'energie, the regulator for Quebec, has approved are credit-supportive and in line with those of other jurisdictions.

Energir also operates in multiple service territories primarily in Quebec and Vermont, through subsidiaries Green Mountain Power Corp. and Vermont Gas Systems Inc., providing some degree of regulatory, geographic, and market diversification.

Further supporting the business risk profile is Energir's customer base that primarily consists of residential and small to medium-sized commercial customers that are less sensitive to economic cycles. In Quebec, Energir has a relatively large industrial user base that contributes a material portion of the company's cash flow; however, these users' gas consumption largely depends on the price of natural gas. Given that natural gas is relatively cheap compared with other fuel sources, we do not expect fuel switching among industrial users to be a credit risk.

Offsetting factors to Energir's business risk includes its investment in generation assets and nonregulated operations which have higher business risk. Furthermore, the company has an obligation to supply natural gas, creating some sourcing and operation risk.

Our view of Energir's financial risk is also unchanged. We continue to evaluate Energir's financial risk profile using our low volatility cash flow/leverage benchmarks compared with the typical corporate issuer, which we use for companies with very low-risk regulated business models, and strong management of regulatory risk. For 2019, we expect credit metrics to be lower due to one-time US\$30 million refund associated with U.S. tax reform. Under our base-case scenario which include capital spending of about C\$550 million in 2019-2020 and distributions and dividends of about C\$215 million. We forecast adjusted funds from operations (AFFO) to debt of about 15% in 2019 and about 16% in 2020 and after.

In addition, Energir has about C\$892 million of subordinated debentures due to its parent company, Noverco Inc., which we have excluded from our leverage and coverage calculations because we treat this as a form of equity financing, consistent with our non-common equity financing criteria. Specifically, these notes are subordinated and have maturity dates beyond those of all debt at the Energir level. This would prevent the non-common equity financing from becoming due and payable until any senior debt has been fully repaid.

## **Outlook**

The stable outlook reflects S&P Global Ratings' expectation that Energir will continue generating stable and predictable consolidated cash flows from its low-risk regulated utility operations in Quebec and Vermont during our two-year outlook horizon. The outlook also reflects our expectation that management will continue to focus on its core regulated business and that the company will not experience any adverse regulatory decisions during our outlook horizon.

### **Downside scenario**

We could take a negative rating action on Energir if the company's credit metrics deteriorate, with AFFFO to debt falling to and staying below 14% with no prospect for improvement. This could happen because of an adverse regulatory decision, a material debt-financed acquisition, or if the company encounters significant operating challenges.

Alternatively, any material weakening of Energir's business risk could also result in a downgrade. This could happen if the company materially increases its unregulated or generation operations.

### **Upside scenario**

Although unlikely, we could raise the rating on Energir if the company demonstrates long-term sustainable low-risk growth or improved financial measures resulting in AFFFO to debt that is consistently near or above 20%.

## **Company Description**

Energir, formerly known as Gaz Metro Inc., is a Quebec-based diversified energy company with more than C\$7 billion in assets. It is the largest natural gas distribution company in Quebec, where its network of over 10,000 kilometers of underground pipelines serves 300 municipalities and more than 205,000 customers.

Energir is also present in Vermont, producing electricity and distributing electricity and natural gas to meet the needs of more than 315,000 customers. In addition, the company is involved in the transportation of natural gas and other businesses like energy services and storage. These form a small portion of Energir's consolidated cash flows.

## **Our Base-Case Scenario**

- Energir will continue to focus primarily on its regulated utility operations.

- Non-regulated energy and non-energy related activities continue to comply with covenant requirements.
- The company will not experience any adverse and material regulatory decisions, and the regulatory regimes in Quebec and Vermont will remain stable and transparent.
- U.S. tax reform results in a refund of about US\$30 million in 2019 and US\$4 million per year thereafter.

## **Liquidity**

In our assessment, Energir's liquidity is adequate. We expect liquidity sources to exceed uses by more than 1.1x over the next 12 months. In the event of a 10% decline in EBITDA decline, we also expect liquidity sources will cover uses. In our view, the company has sound relationships with banks and a generally satisfactory standing in the credit markets. In the unlikely event of liquidity distress, we expect Energir to scale back its capital spending to preserve its liquidity position.

Principal liquidity sources:

- Cash and liquid investments of around C\$58 million;
- Committed credit facility availability of about C\$520 million, maturing in 2023; and
- Cash FFO of about C\$505 million over the next 12 months.

Principal liquidity uses:

- Debt maturities of about C\$215 million including both long-term and short-term debt;
- Maintenance capital expenditures of approximately C\$275 million over the next 12 months; and
- Cash distributions (including dividends) of approximately C\$220 million over the next 12 months.

## **Environmental, Social, And Governance**

Energir's exposure to environmental risk is quite manageable compared with its utility peer group because its operations are primarily in electric and gas distribution, which are more favorably positioned than their counterparts with significant ownership of power generation assets. Although Energir owns some generation assets, they are primarily from renewable and clean energy sources including wind, hydro, and solar with some bio-methane, which has a much lower carbon footprint compared to other forms of power generation. Furthermore, the company is also reducing its greenhouse gas footprint in the gas distribution operation with the participation in the Quebec's cap-and-trade system.

Energir serves over 300 municipalities throughout Quebec. As a utility

operator, due to the nature of Energir's business, its operations may have consequences on the safety and quality of life for some local communities. In order to minimize the impact on communities and better understand its customers' needs, Energir has implemented a social acceptability initiative that includes dialogue and discussions with local stakeholders to ensure accurate understanding of the community's needs prior to the start of its projects. Social acceptance of projects will facilitate better integration of projects into the community that can somewhat reduce project execution risk.

From a governance perspective, we view Energir's governance factors as neutral to our environmental, social, and governance (ESG) assessment. Energir's governance practices are consistent with what we see across the industry for other regulated gas and electricity transmission and distribution (T&D) utilities.

## **Issue Ratings - Recovery Analysis**

Energir has secured utility bonds (first mortgage bonds [FMBs]) outstanding with maturities of 2019-2048. These FMBs are secured under trust deeds that contain a hypothec on Energir's assets. A first immovable hypothec on Energir L.P.'s pipelines and gas distribution system also covers creditors. We estimate that the regulated capital value at Energir is between 1.0x-1.5x of the secured utility bonds outstanding. This results in a '1' recovery rating, and an 'A' rating on the FMBs, same as Energir's issuer credit rating.

## **Ratings Score Snapshot(Energir Inc.)**

Issuer 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)
- Financial policy: Neutral (no impact)



- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: a

- Group credit profile: a
- Status within group: Parent (no impact)

## **Related Criteria**

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - Utilities: Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## **Ratings List**

Ratings Affirmed

Energir Inc.  
Energir, L.P.

*Research Update: Energir Inc. And Energir L.P. Ratings Affirmed, Outlook Stable; First-Mortgage Bond Rating Lowered To 'A'*

Issuer Credit Rating	A/Stable/--	
Green Mountain Power Corp.		
Issuer Credit Rating	A-/Stable/--	
Energir Inc.		
Commercial Paper	A-1	
Commercial Paper	A-1(MID)	
Green Mountain Power Corp.		
Senior Secured	A	
Recovery Rating	1+	
Ratings Downgraded; Recovery Ratings Revised		
	To	From
Energir Inc.		
Senior Secured	A	A+
Recovery Rating	1	1+

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