



Insight beyond the rating.

Energy Update & Credit Rating Considerations

Presented by
Michael Caranci
Managing Director
Energy

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Regulatory treatment is critical for utility credit quality, as it plays a large role in determining business risk

- Stability/predictability of approved ROE and deemed equity in the capital structure.
- Timely recovery of prudently incurred capital expenditures.
 - Lag between when expenditures are made and when assets are completed, enter rate base, and cash earnings begin.
 - Limited instances of regulators allowing a cash return on construction work in process, typically seen only in some U.S. jurisdictions.
- How responsive and/or supportive is the regulator
- The extent of commodity price risk.
 - Even if ultimately 100% pass-through, can impact liquidity requirements given time lag of recovery.

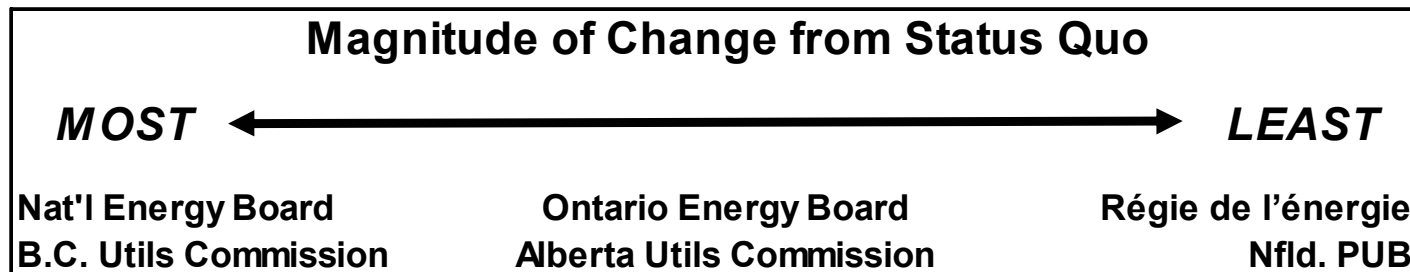
The fourth quarter of 2009 saw six Canadian regulatory decisions concerning cost of capital

- While ROEs declining with government yields was not new, utilities faced a fresh challenge in 2009 – increasing corporate credit spreads which peaked early in the year.
- The result was a long-term cost of debt rapidly approaching approved ROE levels.
- While corporate credit spreads have declined from peak levels, it was a signal that ROE adjustment mechanisms needed to be reviewed in the context of a rapidly evolving financial market.

Cost of Capital Developments



- There were some common themes in the Q4 decisions, primarily that the formulas had either **not provided a fair return**, or **had not kept up with changing financial conditions**.
- In terms of the magnitude of change of the six decisions, DBRS groups them into three general buckets:



Cost of Capital Developments



NEB: Suspension of the Multi-Pipeline Cost of Capital Decision

BCUC: For Terasen Gas, ROE +107bps, equity thickness +499bps, elimination of adjustment formula

OEB: *Estimated* ROE +135bps, addition of a utility credit spread measure into formula, no increase in equity thickness

AUC: ROE +39bps, equity thickness +100bps to +400bps

Régie: GMLP received +56bps ROE, no change in capital structure

PUB: Newfoundland Power +52bps in ROE, no cap structure change

OEB Decision Specifics

- Increase in 2010 ROE over what would otherwise have been.
- Adjustment formula to incorporate the addition of a corporate bond yield variable which should dampen ROE volatility
- Possible move toward using an LDC's actual cost of debt rather than a deemed value.
- No change to equity components.
- Decision viewed as a positive for the credit profile of affected Ontario utilities.

DBRS View of Recent Decisions

- All decisions viewed positively in the context of an affected utility's financial risk profile.
- However, deteriorating ROE levels had not had a direct negative effect on DBRS utility ratings.
- Therefore, recent ROE/equity thickness levels would likely not, in themselves, result in positive rating actions.
- However, the improvements are viewed as supportive of current ratings and would improve flexibility within a rating category.

- Enabled by the *Green Energy Act*, the feed-in tariff program (FIT) has established a new procurement process for renewable generation.
- FIT features standard guidelines, rules, contracts & pricing.
- Should streamline an approvals/permitting process that has caused delays in the past.
- Allows for LDCs to directly own renewable generation facilities that are <10MW.
- Provides an LDC some choice in ownership/funding structures.

Basic LDC options for generation investment

- Hold inside/outside LDC
- Fund investment on a corporate or possibly project/non-recourse basis

Credit profile considerations for an LDC considering generation:

- Materiality of investment
- Ownership structure
- Financing plan
- Construction/operating risk profile
- Financial risk profile

DBRS Ontario-based Utility & Related Ratings



<u>Company</u>	<u>Rating (s)</u>	<u>Trend</u>
Electricity Distributors Finance Corp.	A (low)	Stable
Enersource Corporation	A	Stable
Enwin Utilities Ltd.	A (low)	Stable
Hydro Ottawa	A	Stable
PowerStream Inc.	A	Stable
Toronto Hydro	A (high) / R-1 (low)	Stable
Veridian Corporation	A	Stable
PowerStream Inc.	A	Stable
Hydro One Inc.	A (high) / R-1 (middle)	Stable
Ontario Power Authority	A (high)	Stable
Ontario Power Generation	A (low) / R-1 (low)	Stable
Enbridge Gas Distribution Inc.	A / R-1 (low)	Stable
Union Gas Limited	A / R-1 (low)	Stable

Contact Information



Michael Caranci
Managing Director- Energy
+1 416 597 7304
mcaranci@dbrs.com

www.dbrs.com

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