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Credit Opinion: Questar Corporation

Global Credit Research - 03 Sep 2014

Salt Lake City, Utah, United States

Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured	A2
Commercial Paper	P-1
Questar Pipeline Company	
Outlook	Stable
Senior Unsecured	A3
Questar Gas Company	
Outlook	Stable
Senior Unsecured	A2

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Key Indicators

[1]**Questar Corporation**

	LTM 2Q14	12/31/2013	12/31/2012	12/31/2011
CFO pre-WC + Interest / Interest	**8.2x**	**8.6x**	**8.7x**	**8.4x**
CFO pre-WC / Debt	**32.2%**	**32.0%**	**29.8%**	**32.1%**
CFO pre-WC - Dividends / Debt	**24.1%**	**24.6%**	**23.1%**	**25.2%**
Debt / Capitalization	**44.5%**	**47.0%**	**51.6%**	**51.0%**

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

Constructive regulatory environments support a low risk business profile

Majority of cash flow from stable and predictable pipeline and gas distribution subsidiaries

Unique Wexpro and Wexpro II arrangements mitigate some E&P risks

Financial metrics expected to decline over the near-term, a credit negative

Corporate Profile

Questar Corporation (Questar) is an integrated holding company engaged in the cost-of-service production and the regulated transportation and local delivery of natural gas in the Rocky Mountain region of the United States. Its principal subsidiaries are Wexpro Company (Wexpro; not rated), Questar Gas Company (Questar Gas; A2 stable), and Questar Pipeline Company (Questar Pipeline; A3 stable). Questar's other operations also include Questar Fueling Company (not rated), which provides consulting and installations services for natural gas fueling stations.

Wexpro, a quasi-regulated exploration and production (E&P) company, develops cost-of-service defined gas reserves whose production is dedicated to Questar Gas. Through LTM June 30, 2014, Wexpro had about 65 Bcf of cost-of-service deliveries.

Questar Gas is a local distribution company (LDC) that serves approximately 950,000 customers in mostly Utah but also Wyoming and Idaho. Questar Gas is regulated by the Public Service Commission of Utah (PSCU), the Public Service Commission of Wyoming (PSCW) and Idaho Public Utilities Commission.

Questar Pipeline provides transportation and underground storage for Questar Gas, other utilities and export pipelines in Utah, Wyoming and Colorado. Questar Pipeline's operates just under 2,700 miles of pipe and is regulated by the Federal Energy Regulatory Commission (FERC).

SUMMARY RATING RATIONALE

Questar's rating reflects the combined credit quality of its three operating subsidiaries which collectively exhibit a relatively low risk business profile thanks to constructive regulatory frameworks in Utah and Wyoming. Questar's rating is underpinned by the stable and predictable cash flow generation provided by gas distribution and gas pipeline infrastructure assets, while its more risky exploration and production (E&P) subsidiary, Wexpro, predominantly serves its affiliate, Questar Gas, under a cost-of-service quasi-regulated sales agreement. This relationship, governed by the Wexpro Agreement and Wexpro II Agreement (see below), helps to reduce the business risk of the overall family and counterbalances a growing capex program that will contribute to a lower level of financial metrics over the next two years.

Questar Gas' rating reflects the regulatory environment, cost recovery mechanisms and organic growth in its predominant Utah jurisdiction. Similarly, Questar Pipeline's rating are supported by FERC regulation and contract lives that average about 7 years in duration as of August 31, 2014.

DETAILED RATING CONSIDERATIONS

REGULATORY SUPPORT IS THE PRIMARY CREDIT DRIVER

Questar's rating is underpinned by the predictable cash flow generation provided by gas distribution and gas pipeline infrastructure assets. Each of these subsidiaries contribute approximately $140 million of cash flow from operations (CFO) per year and combine to produce roughly 60% of Questar's annual CFO. The cash flow provided by these segments is predictable given the low-risk nature of regulated operations. The Utah and Wyoming regulatory environments provide Questar gas with supportive general rate case outcomes, which allow the company to recover prudently incurred costs on a timely basis, while the FERC regulatory environment is viewed as one of the strongest regulatory regimes in the US, given the formulaic (i.e., highly predictable) nature of its rate structure and high allowed ROE's (e.g., Questar Gas has an allowed ROE of 9.85% in Utah, versus Questar Pipeline's 11.75% allowed ROE).

The remaining 40% of consolidated cash flow is contributed from Wexpro, a quasi regulated exploration and production (E&P) subsidiary. Wexpro manages, develops and produces cost-of-service reserves for Questar Gas under contractual arrangements (the Wexpro Agreement and Wexpro II Agreement) that allow Wexpro to recover its costs and receive an unlevered, after-tax return of approximately 20% on its investment base. Wexpro sells a small amount of oil and gas liquids production to third parties and its revenues in excess of cost recovery and return on investment is shared with Questar Gas, which uses those earnings to reduce customers' natural gas rates. This supply relationship, with cost recovery having been approved by the PSCU and PSCW since 1981, effectively makes Wexpro a regulated entity with no commodity price risk and little capital re-investment risk.

Questar Gas further benefits from various interim cost recovery mechanisms which accelerate the recovery of its investments and stabilize cash flow. For example, the company's revenue decoupling mechanism and weather normalization adjustment help to provide revenue and cash flow certainty, despite fluctuations in customer use patterns. Importantly, the decoupling mechanism also helps Questar Gas to recover its fixed charges in a flat to declining demand environment, which mitigates volume risk. Questar Gas also utilizes an infrastructure rider to place into rate base, immediately upon project completion, capital expenditures associated with a multi-year high-pressure natural gas feeder-line replacement program. We expect this replacement program to continue to keep Questar Gas' capital expenditures elevated for several years, so this cost tracking mechanism will help accelerate the recovery of this investment and help to maintain the company's financial profile.

The supportive regulatory treatment provided by various regulatory bodies gives Questar a high degree of revenue and cash flow stability and predictability. Furthermore, the Wexpro Agreements and strong cost recovery history for Questar's E&P activities also helps to de-risk operations that are typically of a higher-risk nature. The oversight of regulatory bodies gives the entire operational chain of Questar a low business risk profile and provides the foundation for its high investment grade ratings.

INTEGRATED BUSINESS PROFILE IS KEY TO STRATEGIC ADVANTAGES

Questar's operations form a vertically integrated chain of operations from gas development E&P assets at Wexpro, to interstate transportation of natural gas at Questar Pipeline, to local distribution of gas to end-use customers by Questar Gas. The interrelated nature of these operations provides stability to each entity's earnings as each company depends upon the others to provide low cost energy supply. These relationships are key components to consolidated operations and Questar's rating.

For example, all of Wexpro's natural gas production is sold to Questar Gas, which aims to satisfy 65% of the LDC's supply requirements. Questar Gas, in turn, represents nearly 90% of Wexpro's revenue, with the remaining portion of Wexpro's revenue being derived from oil and natural gas liquid (NGL) sales to the market. Questar Gas is also Questar Pipeline's largest transportation and storage customer, as the LDC uses about half of the company's total daily transmission throughput. However, Questar Gas represents a declining proportion of its Questar Pipeline's market, as the pipeline is increasingly focused on exporting more third-party gas volumes out of the Rockies where a majority of its ultimate markets are reached through interconnects to other pipelines going east and west.

Finally, any operating income from Wexpro's oil and NGL production remaining after recovery of expenses and Wexpro's return on investment is shared between Questar Gas customers (54%) and Wexpro (46%). The sharing reduces end-use customer rates, which has helped to keep Questar Gas' rates among the lowest in the nation among LDCs.

FINANCIAL METRICS ARE EXPECTED TO DECLINE OVER THE NEAR-TERM

Questar continues to benefit from a robust level of cash flow to interest payment and debt levels. Through LTM 2Q14, the company has produced cash flow from operations before changes in working capital (CFO pre-WC) interest coverage of 8.2x and CFO pre-WC to debt of 32%. These financial metrics are supported by Wexpro's 20% ROE levels and continued regulatory support for a relatively high degree of organic growth in Questar Gas' service territory (i.e., Moody's Economy.com predicts increasing growth in net migration in Salt Lake City, Aaa, through 2018), along with the proposed acquisition of Eagle Mountain City's (not rated) municipal gas system. However, with increased capital spending in each business segment and the absence of tax relief from bonus depreciation (we exclude the impacts of bonus depreciation in our financial projections), we see Questar's CFO pre-WC to debt steadily declining to just above 25% over the next three years.

Wexpro's growth will continue through acquisitions and potentially through additional Wexpro Agreements, Questar Gas' capex will be directed toward infrastructure replacement and improvement, and Questar Pipeline's primary source of growth capex comes from its 50-50 development agreement with Spectra to re-commission the western portion of its Southern Trails Pipeline. This project, called the Inland California Express (ICE), aims to alleviate congestion on the rail system entering the Los Angeles region, as the pipeline will deliver crude oil from railcars to refineries in Long Beach, California. The eastern segment of Southern Trails, which had experienced reduced revenues due to falling transportation rates, was entirely written down with a non-cash impairment of $80.6 million, or $52.4 million after income taxes in 2013.

Although we foresee a financial decline for Questar, cash flow to debt metrics above 25% is still strong for a primarily rate regulated energy company and is well suited for its A2 rating category, compared to peer companies such as Black Hills Corp. (Baa1 stable; another primarily rate regulated utility holding company with E&P exposure) which has produced average CFO pre-WC to debt of 17% since 2011.

Questar Gas, at an expected 20% CFO pre-WC to debt level over the intermediate-term, may be among the weaker financial performers in the A2 category. But for now, Questar Gas is still viewed as well positioned within the range expected for a low risk LDC in a favorable regulatory environment. We expect Questar Pipeline and its formulaic FERC authorized rates to continue to produce FFO to debt just under 30% after the conclusion of the ICE capex (estimated to be in 2017).

PARENT NOTCHING IS UNIQUE DUE TO FINANCIAL STRENGTH OF INTEGRATED OPERATIONS

The combination of Wexpro's quasi-regulated cost recovery and unlevered financial profile help support Questar's A2 consolidated credit strength, which is the same rating as its subsidiary, Questar Gas and 1-notch higher than subsidiary Questar Pipeline. This rating relationship is unique in the US utility sector, since many holding company ratings are notched lower than their subsidiaries for structural subordination or even multi-notched if there is a significant amount of consolidated debt (e.g., greater than 20%) located at the holding company level.

Questar maintains approximately $250 million of debt at the holding company, which equates to about 20% of the total consolidated $1.3 billion of long-term debt, at June 30, 2014. Questar is able to maintain its A2 rating due to the interrelated operations of the integrated family, along with a degree of regulatory certainty that is associated with Wexpro's strong financial metrics and robust ROE.

Liquidity Profile

Questar manages its liquidity on a consolidated basis, which is augmented with a holding company revolving credit facility of $750 million that expires in April of 2018. The facility also supports the company's $750 million commercial paper program. As of December 31, 2013, there was $276 million of commercial paper outstanding with no direct borrowings under the facility. The credit agreement contains a 70% debt to capitalization covenant, which the company was in compliance with as of June 30.

Questar's internal liquidity consists of under $500 million of cash flow from operations which is roughly our expectation for capital expenditures in each of the next couple years, given the timing of the ICE project and aforementioned growth of the Wexpro and Questar Gas operations. Questar targets a 60% dividend payout ratio, around $130 million through LTM 2Q14, which we consider to be financed in the capital markets. Although the company has maintained a positive free cash flow position, on a Moody's adjusted basis, over the last several years, the continued need to finance negative free cash flow in the capital markets could pressure the P-1 commercial paper rating downward.

Questar's next long-term debt maturity is when $25 million of Questar Pipeline debt comes due in October 2015. Questar's $250 million of holding company debt matures in February 2016.

Rating Outlook

Questar's stable outlook is based on the expectation that Questar will manage its capital structure so that its consolidated cash flow to debt metrics (e.g., CFO pre-WC to debt) will remain above 25%, while maintaining strong liquidity and a quasi regulated cost recovery profile for non-utility operations at Wexpro.

What Could Change the Rating - Up

A positive rating action for Questar could result if it sustains improved credit metrics, including CFO pre-WC to debt over 30% on a sustainable basis.

What Could Change the Rating - Down

Questar's ratings would be downgraded if there were a weakening in cost recovery provisions provided by the UPSC and WPSC, such as modifications to the Wexpro Agreements or a lack of rate support for gas distribution activities. If Questar's consolidated financial profile were to decline, such that CFO pre-WC to debt fell below the mid-20% range for an extended period, or if Wexpro's cash flow to parent company debt dropped below 30%.

Rating Factors

Questar Corporation

Regulated Electric and Gas Utilities Industry Grid [1][2]	**Current LTM 6/30/2014**		[3]**Moody's 12-18 Month Forward ViewAs of Date Published**	
Factor 1 : Regulatory Framework (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Legislative and Judicial Underpinnings of	A	A	A	A

the Regulatory Framework				
b) Consistency and Predictability of Regulation	A	A	A	A
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	A	A	A	A
b) Sufficiency of Rates and Returns	Aa	Aa	Aa	Aa
Factor 3 : Diversification (10%)				
a) Market Position	Baa	Baa	Baa	Baa
b) Generation and Fuel Diversity				
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	8.5x	Aaa	6.5x - 7.0x	Aa
b) CFO pre-WC / Debt (3 Year Avg)	32.0%	Aa	22 - 27%	A
c) CFO pre-WC - Dividends / Debt (3 Year Avg)	24.5%	Aa	15 - 20%	A
d) Debt / Capitalization (3 Year Avg)	47.5%	A	49 - 53%	Baa
Rating:				
Grid-Indicated Rating Before Notching Adjustment		A1		A2
HoldCo Structural Subordination Notching				
a) Indicated Rating from Grid		A1		A2
b) Actual Rating Assigned		A2		A2

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 6/30/2014(L); Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on http://www.moodys.com for the most updated credit rating action information and rating history.

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