State of Utah
Department of Commerce
Division of Public Utilities

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Memorandum

TO: Public Service Commission

FROM: Division of Public Utilities
Philip Powlick, Director,
Artie Powell, Energy Manager
Charles Peterson, Technical Consultant
Doug Wheelwright, Utility Analyst

DATE: September 7, 2010

RE: Questar Gas Dividend Declaration August 10, 2010

I. ISSUE

On August 10, 2010 the Board of Directors of Questar Gas Company (QGC) declared a quarterly cash dividend of $7,200,000 on the outstanding shares of QGC common stock. The dividend is payable to the Company's sole shareholder, Questar Corporation, on September 13, 2010.

Pursuant to Utah Code Annotated 54-4-27, the Company must notify the Commission of the dividend within five days of its declaration. The Commission has 30 days from the dividend declaration date to investigate whether the payment of such dividend would result in impairment of the capital or to the utility's service to the public, and if it finds that such impairment will or may occur, the Commission may order that the dividend not be paid.

II. RECOMMENDATION (No Action)

Based upon the following analysis, the Division finds no indication that the capital and operations of Questar Gas Company will be impaired pursuant to UCA 54-4-27. Therefore, the Division recommends that the Commission take no action.

III. ANALYSIS

In approaching this assignment, the Division understands the terms “impaired” and “impairment” in the statute to mean that (1) the payment of the dividend will result in actions being taken against the Company by creditors, rating agencies, or others due to a reduction in the value of the capital, the violation of loan covenants, or other agreements; (2) the payment of the dividend would result in a reduced ability of the Company to provide service through a lack of working capital or other financial capacity to continue its operations in the same manner as it would if the dividend were not paid.

The Division of Public Utilities investigated the effects of the dividend on the capital and cash flows of the Company using the latest financial information available. This included the annual financial statements through December 31, 2009, the quarterly financial report as of June 30, 2010, Questar Corporation News Release dated August 10, 2010, and a review of the Company’s bond rating from the various bond rating agencies.

Exhibit 1 sets forth financial results for the years ended December 31, 2004 through the second quarter of 2010. Total revenue for the year ended December 31, 2009 was down 8.0% from $1,000.3 million to $919.9 million. While total revenue was down, net income increased 3.5% from $40.2 million to $41.6 million. Total natural gas costs as a percent of sales showed a significant decrease from 73.7% in 2008 to 68.1% in 2009. Earnings from Operation increased 3.2% from $84.2 million in 2008 to $86.9 million in 2009. Compared to previous years, 2009 appears to have been very profitable for the Company. The average net profit margin for 2004 through 2009 was 3.96% while the margin for 2009 was 4.52%. This was higher than any other year under review.

Revenue for the first six months of 2010 was $509.7 million, down 6.4% from the same period in 2009. Operating Income increased from $58.8 million in 2009 to $59.7 million in 2010 for a 1.5% increase. Net income increased from $29.8 million in 2009 to $30.9 million in 2010 for a

3.7% increase. The temperature adjusted usage per customer decreased 2.2% in the first half of 2010 compared to the same period in 2009.

From 2000 to 2008, dividends on common stock have consistently increased by $500,000 each year. Beginning with the dividend in the fourth quarter of 2009 this policy has changed. Instead of a constant dollar amount from Questar gas, the dividends will be based on the historical payout ratio of the various subsidiaries of Questar Corp. The Company paid $28.2 million in 2009 for an increase of $700,000 over the previous year.

The balance sheet information set forth on pages 2 and 7 of Exhibit 1 identifies a decrease in accounts receivable from $174.6 million in 2008 to $166.9 million in 2009. The net plant in service increased steadily over the 2004 to 2009 period averaging a 6.8% annual increase while total assets increased at an average rate of 5.8%. With the slowdown in the economy, capital expenditures have been reduced from a high of $135.9 million in 2007 to $82.6 million in 2009. Capital expenditures have increased during 2010 with the feeder line replacement program to $50.9 million through June 2010.

The Company's capital structure remains near the historical average of 48.6% debt and 51.4% equity. Long-term debt increased at an average rate of 6.3% from 2004 through 2009. Total long term debt is currently $370.0 million. Common equity grew at an average rate of 4.8% for the period under review and included a $30 million equity contribution from the parent company in 2008. Of special note is the note payable to Questar Corporation. Notes payable to the parent company has varied widely from a high of $95.2 million in 2004 to a low of $13.2 million in 2006. As of June 30, 2010 the account balance was $53.9 million, down from $87.0 million as of December 31, 2009. It appears that Questar Gas uses its parent company as a "bank" from which it obtains short-term loans according to its need for liquidity.

Effective July 1, 2010, Questar Corporation completed a spin-off of the company's natural gas and oil exploration and production (E&P) business into QEP Resources, Inc. (QEP). QEP is comprised the former Questar Exploration & Production, Questar Gas Management and Questar Energy Trading. Shareholders of record as of June 18, 2010 were issued 1 share of QEP for each share of Questar Corp. As a result of the spin-off, Standard & Poor's upgraded Questar Gas from BBB+ to A as of July 8, 2010. Questar Corp. does not issue debt at the parent-company level. The parent instead issues debt at the subsidiary level, primarily to provide capital-structure clarity for regulatory purposes.[1] Questar Gas' parent, Questar Corporation was also upgraded from A-2 to A-1.

The Company filed a general rate case in December 2009 and on April 8, 2010, the Company entered into a stipulation agreement to settle all issues in this case. The agreement sets the allowed rate of return at 10.35%, continues the Conservation Enabling Tariff (CET) and establishes a mechanism to adjust rates for a feeder-line replacement. The new rates became effective August 1, 2010.

Page 4 of Exhibit 1 calculates the financial ratios and other information for the periods under review. Short-term liquidity ratios for year-end 2009 are near the historical averages with the current ratio at 0.87 and the quick ratio at 0.54. The long-term solvency ratios are near the historical averages with Net Worth / Total Debt at 0.42 and Net Worth / Fixed Assets at 0.39. The profitability ratios are strong and are near the historical averages with Return on Assets at 4.5% and Return on Total Capital of 7.8%. On an SEC financial reporting basis, the Company had a return on equity (ROE) of 10.6% for 2009. The company's authorized return on equity is 10.0% and is calculated based on different regulatory guide-lines. The Company has provided a reconciliation of the regulatory ROE calculated at 9.73%. Included in the Other Financial Indicators section are four calculations used by Moody's as part of their bond rating guidelines. These include the EBIT / Interest, Debt / Book, Retained Cash Flow / Debt and Simple ROE. All of these ratios are within the guidelines specified for year-end 2009. The financial characteristics of Questar Gas generally indicate a profitable and stable utility company.

[1] Questar Comments on Moody's Rating,, http://prnwire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/11-12-2002/0001839749&EDATE= > < Accessed June 9, 2010

A new report has been included as page 5 of Exhibit 1. This report looks at the revenue by customer class and the natural gas costs per dekatherm (dth) for each year under review. Residential and commercial sales provided 95.0% of the total revenue dollars but represented 64.8% of the total volume. Natural gas cost per dth continues to come down from $6.14 in 2008, $5.01 in 2009, to $3.51 for the first 6 months of 2010. The cost of natural gas fell 13% in the first half of 2010 compared to the first half of 2009. Total customers increased 1.1% in 2009 to 898,558 and have continued to increase to 905,700 for a 0.8% increase for year to date 2010.

The growth in common equity has been slower than the growth of the Company generally and is slower than the growth of comparable natural gas companies. The dividend policy and large payout ratio is contributing to that slower growth in equity. Questar Corporation owns 100% of the stock in Questar Gas and all of the $7.2 million quarterly dividend will be paid to the Corporation. The total amount of dividends paid in 2009 was $28.2 million. The 2009 payout ratio was 67.8%, which is lower than the historical average of 71.9%. While the payout is lower than the historical average, it represents a significant cash requirement for the Company and is greater than the dividend payout for comparable companies. The slower growth in the equity position can be looked at from both a positive and a negative perspective. The lower equity position allows the company to have lower net earnings in order to maintain the allowed return on equity. The cash requirement from the Company to the parent could become an issue if the total profitability were to go down. Questar Gas Company should have adequate cash flows to maintain its service obligations and meet its financial needs.

The Division has made its own *pro forma* analysis and forecast of the financial results of Questar Gas. The analysis assumes a level of profitability consistent with past performance. The forecast has also attempted to account for forecasted capital expenditures, but assumes that other expenses and accounts are kept in line with the historical results. It is anticipated that the Company will increase the capital expenditures in 2010 and beyond as part of a feeder line replacement program and dividends on common stock are assumed to increase each year. While the forecast is based upon a number of assumptions that appear reasonable at this time, actual results will vary. With this caveat in mind, the Division concludes that there is no indication that the assumed level of dividends, capital expenditures and debt will materially and negatively impact the financial health of Questar Gas. The Company is projected to maintain profitability levels similar to historical results. The Division will continue to monitor the actual results and the regulated return on equity.

IV. CONCLUSION

The Division concludes that the payment of a $7,200,000 common dividend declared by Questar Gas's Board of Directors is within the discretion of the Company and it appears that there will be no impairment of the capital and the services rendered by the Company because of this dividend payment.

cc: Barrie McKay – Questar Gas
Michele Beck – Office of Consumer Services