MOODY'S
INVESTORS SERVICE

Credit Opinion: Questar Corporation

Global Credit Research - 30 Oct 2015

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

Contacts

Analyst	Phone
Ryan Wobbrock/New York City	212.553.7104
William L. Hess/New York City	212.553.3837

Key Indicators

[1]**Questar Corporation**

	6/30/2015(L)	12/31/2014	12/31/2013	12/31/2012	12/31/2011
CFO pre-WC + Interest / Interest	8.3x	8.6x	8.6x	8.7x	8.5x
CFO pre-WC / Debt	29.1%	27.8%	32.2%	30.4%	32.4%
CFO pre-WC - Dividends / Debt	20.7%	20.5%	24.8%	23.5%	25.4%
Debt / Capitalization	45.5%	48.0%	46.8%	51.1%	50.8%

[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

Strong regulatory support for integrated gas operations is primary credit driver

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

Wexpro is credit negative because of its more risky E&P operations, and it is facing reduced returns

Financial metrics expected to modestly decline over next 2-3 years

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), designs, builds, owns and manages compressed 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, 2015, Wexpro had about 57 Bcf of cost-of-service deliveries, down from 65 Bcf through LTM June 30, 2014.

Questar Gas is a local distribution company (LDC) that serves nearly 980,000 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).

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

SUMMARY RATING RATIONALE

Questar's A2 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, (which accounts for 40% of consolidated cash flow) predominantly serves a strong investment grade 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 traditional E&P business risk for the company, but proposed refinements to future investments will likely reduce profitability.

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 8 years in duration as of October 2015.

DETAILED RATING CONSIDERATIONS

REGULATORY SUPPORT FOR AN INTEGRATED PROFILE IS CREDIT POSITIVE

Questar's A2 rating is founded on the strong regulatory support that the company receives in Utah and Wyoming, which allows it to function as a vertically integrated gas company. The unique operating profile of the company consists of 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 is supported by regulated cost recovery provisions, which have a high degree of interdependence.

For example, all of Wexpro's current natural gas production is sold to Questar Gas, which aims to satisfy up to 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 15% of the company's total daily transmission throughput. 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.

Even Questar's most risky segment, Wexpro, is a quasi-regulated 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 direct commodity price risk and little capital re-investment risk, in our opinion.

PROPOSED CHANGES TO WEXPRO INVESTMENT RECOVERY UNDERSCORES INTEGRATED FOCUS

The recent downturn in oil and gas prices has made Wexpro's supply uneconomical, forcing the company to scale back its drilling efforts in 2015, and limit its investments to the completion of wells drilled in 2014. Based on the current five-year forward natural gas price curve and Wexpro's current cost to produce, this trend would continue, thus depleting the segment's asset base and cash flow generation. We estimate that Wexpro's funds from operations has declined from around $220 million in 2013, to $210 million through LTM 2Q15 and would likely drop to $200 million through 2016 under current conditions. While this cash flow reduction would not materially impact Questar's consolidated cash flow to debt metrics, , the general business trend is negative. In an attempt to correct this trend, Questar has continued to pursue Wexpro III agreements (i.e., cost-of-gas supply arrangements with third-party utilities) in addition to modifying the existing structure for investments made in its Wexpro II agreement. Regarding the latter, Questar has filed a proposal with the PSCU and PSCW to lower Wexpro's future rate of return on wells (from nearly 20% today, to Questar Gas' rate base return of 7.64%), curtail future drilling criteria to wells that are projected to produce cost-of-service gas that is price-competitive with five-year forward curve prices and share "dry hole" risk and future market savings 50/50 with Questar Gas. According to the company, the proposed return would make Wexpro drilling economical at today's prices and the proposed drilling criteria would safeguard Questar Gas from paying for future supply that is materially higher than market expectations, while providing upside in any sharing price savings below market prices. Additionally, Questar is of the view that geology in current drilling areas is well-known and that dry hole risk is negligible.

We view the Wexpro proposal as an effort to prop-up an economically challenged, riskier, E&P segment. We also view the proposal as having divergent risk implications for Questar's segments - i.e., it would further lower Wexpro's business risk profile (and lower margins), as it heightens Questar Gas' business risk profile. While the proposal would reduce future costs for the LDC obtaining supply from Wexpro, Questar Gas would be transitioning from a gas taker to becoming a direct investor in physical supply, an inherently riskier position. This is similar to other transactions we've seen in the utility sector (see our May 2015 report "Investments in Gas Reserves Heighten Risks, But Utilities Are Starting Small"), where utilities are opting for direct long-term supply arrangements with an eye toward ensuring price stability, rather than purchasing supply at similar costs (or lower, in most cases) in the current market. If this proposal is accepted, Questar Gas' business risk would increase incrementally with new investments, as all historical Wexpro supply contributions would adhere to Wexpro I and II parameters.

This revised arrangement would likely work as a template for the Wexpro III contracts that Questar is pursuing, including an unnamed utility partner to co-invest in Wexpro's joint venture with Piceance Energy, LLC (unrated) to develop gas in Colorado's Piceance Basin. If the template were to carry forward, Wexpro's future returns would diminish from the robust near-20% levels of today, but the company would benefit by securing a contractual sale of production, utilizing utility balance sheets and cost of capital as investment hurdle rates, maintaining its drilling activity and asset base, sharing of E&P risks and spreading fixed costs across larger volumes of production.

The proposed changes underscores Questar's integrated focus as it is willing to sacrifice returns of a traditional E&P company in order to perpetuate its cost-of-service, quasi-regulated, business model and secure returns. Should the PSCU and PSCW approve the proposed arrangements, we would view that as a sign of further regulatory support for Questar's integrated model.

LOW-RISK GAS TRANSPORTATION AND DISTRIBUTION OPERATIONS

Despite the evolving business of Wexpro, Questar's business and credit profile is underpinned by stable and predictable 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).

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.

FINANCIAL METRICS ARE EXPECTED TO DECLINE OVER THE NEAR-TERM

Questar's financial profile will decline over the next 2-3 years, due to increased capital spending in its regulated businesses and the potential for reduced returns at Wexpro. Whereas the company has produced around 30% CFO pre-WC to debt, on average, over the last three years, we see Questar's CFO pre-WC to debt steadily declining to around 25% as debt increases to fund high capex and Wexpro's incremental investments earn a utility-like return. We see this decline as modest, given its degree of regulatory support.

Questar Gas, at an expected 20% CFO pre-WC to debt level over the intermediate-term (19% through LTM 2Q15), is among the weaker financial performers in the A2 category; whereas Questar Pipeline's formulaic FERC rates will continue to produce FFO to debt just under 30% (27% through LTM 2Q15).

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 long-term debt at the holding company, which equates to about 17% of the total consolidated $1.5 billion of reported long-term debt, at June 30, 2015. Including $228 million of commercial paper outstanding, Questar's holding company debt would be about 32% at June 30, 2015; however, we see short-term borrowings as attributable to the full suite of businesses, especially since Wexpro's reduced capex has that company in a stronger cash position. Furthermore, Wexpro's $210 million of funds from operation is around 40% of all non-regulated consolidated debt (i.e., $60 million of Wexpro debt, plus long-term holding company and commercial paper).

Questar is able to maintain its A2 rating due to the interrelated operations of the integrated family and the supportive regulatory treatment for each link of the integration chain. This regulatory support gives Questar a high degree of revenue and cash flow stability and predictability, even from E&P activities that are typically of a higher-risk nature.

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 June 30, 2015, there was $228 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; the same as its projected capital expenditures over the next 12 - 18 months. Questar has increased its dividend payout target to 65% from 60%, a credit negative. Through LTM 2Q15, the company's dividend was around $140 million, 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 $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%. A downgrade of Questar's A2 rating would also trigger a downgrade of Questar's short-term commercial paper rating, most likely to P-2 from P-1.

Rating Factors

Questar Corporation

Regulated Electric and Gas Utilities Industry Grid [1][2]	**Current LTM 6/30/2015**		[3]**Moody's 12-18 Month Forward ViewAs of 10/30/2015**	
Factor 1 : Regulatory Framework (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Legislative and Judicial Underpinnings of the Regulatory Framework	A	A	A	A
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	N/A	N/A	N/A	N/A
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	8.5x	Aaa	6.5x - 7x	Aa
b) CFO pre-WC / Debt (3 Year Avg)	31.2%	Aa	22% - 27%	A
c) CFO pre-WC - Dividends / Debt (3 Year Avg)	23.2%	A	15% - 20%	A
d) Debt / Capitalization (3 Year Avg)	45.8%	Baa	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

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 6/30/2015(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.

control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from $1,500 to approximately $2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

For Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail clients. It would be dangerous for "retail clients" to make any investment decision based on MOODY'S credit rating. If in doubt you should contact your financial or other professional adviser.

For Japan only: MOODY'S Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of MOODY'S Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.
MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.