State of Utah
Department of Commerce
Division of Public Utilities

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Memorandum

TO: Public Service Commission

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

DATE: August 24, 2011

RE: Questar Gas Dividend Declaration August 9, 2011

I. 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.

II. ISSUE

On August 9, 2011 the Board of Directors of Questar Gas Company (QGC) declared a quarterly cash dividend of $7,575,000. The dividend is payable to the Company's sole shareholder, Questar Corporation, on September 12, 2011.

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.

III. ANALYSIS

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, 2010, quarterly financial statements as of June 30, 2011, Questar Corporation News Release dated August 9, 2011, 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, 2006 through June 30, 2011. As of December 31, 2010, total revenue was down 1.85% from $919.9 million to $902.9 million. While total revenue was down, net income increased 5.53% from $41.6 million to $43.9 million. The natural gas costs as a percent of sales showed a decrease from 68.12% in 2009 to 65.59% in 2010. Earnings from Operation increased 1.96% from $86.9 million in 2009 to $88.6 million in 2010. Compared to previous years, 2010 was the most profitable of all the years under review. The average net profit margin for 2005 through 2010 was 4.08% compared to the 2010 margin of 4.86%. On an annual basis, approximately 50% of the natural gas volume is provided through Wexpro.

For the year 2010, the Company experienced a 1.22% increase in the number of customers from 898,600 to 909,600. As of June 30, 2011, Questar Gas served 913,571 customers, up 0.9% from 905,745 as of June 30, 2010. During 2010 the temperatures were 1.00% colder than normal, however, the temperature adjusted usage per customer went down 1.93% from 109.0 dth in 2009 to 106.9 dth. The usage per customer has been moving down each year from the peak in 2006 of 113.6 and is due in part, to consumer conservation efforts encouraged by the current Demand Side Management program (DSM). While usage per customer has decreased, the company has been able to remain profitable in part due to the Conservation Enabling Tariff (CET).

Total revenue for the first six months of 2011 increased by $70 million compared to the same period in 2010. During this same period, operating expenses increased $62.2 million and net income increased $2.9 million. Because of the seasonal nature of its business, the Company typically reports higher income in the first and fourth quarters of the year. Temperatures for the first 6 months of 2011 were 4% colder than normal resulting in an increase in the adjusted usage per customer.

The balance sheet information on pages 2 and 7 of Exhibit 1 identifies an increase in accounts receivable from $166.9 million in 2009 to $171.3 million in 2010. The net plant in service has increased steadily from 2005 through 2010 averaging a 7.39% annual increase while total assets increased at an average rate of 4.98%. Capital expenditures increased from $82.6 million in 2009 to $108.6 million in 2010 partially due to the current feeder line replacement program.

The Company's regulatory capital structure is currently 45.98% debt and 54.02% equity and is slightly different than the historical average with of 48.67% debt and 51.33% equity. Long-term debt increased at an average rate of 2.64% from 2005 through 2010 and is currently $368.0 million. Of special note is the note payable to Questar Corporation. Short term notes payable to the parent company have varied widely from the low of $13.2 million in 2006 to a high of $153.6 million as of December 2010. As of June 30, 2011, the note to Questar Corporation has been paid down to $44.0 million. It appears that Questar Gas continues to use its parent company as a "bank" from which it obtains short-term loans according to its need for liquidity. Common equity grew at an average rate of 5.47% for the period under review and included a $30 million equity contribution from the parent company in 2008.

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 to A- by S&P and to A3 by Moody's.

Page 4 of Exhibit 1 calculates the financial ratios for the periods under review. Short-term liquidity ratios for year-end 2010 are near the historical averages with the current ratio at 0.84 and the quick ratio at 0.51. The long-term solvency ratios are near the historical averages with Net Worth / Total Debt at 0.42 and Net Worth / Fixed Assets at 0.38. The profitability ratios are near the historical averages with Return on Assets at 4.46% and Return on Total Capital of 7.87%. On an SEC financial reporting basis, the Company had a return on equity (ROE) of 10.97% for 2010. The company's authorized return on equity is 10.35% and is calculated based on different regulatory guide-lines. The Company is currently working on a reconciliation of the financial and regulatory ROE. 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 Capitalization, Retained Cash Flow / Debt and a Simple ROE calculation. All of these ratios are within the guidelines specified as of year-end 2010. The financial characteristics of Questar Gas generally indicate a profitable and stable utility company.

Page 5 of Exhibit 1 includes the operating statistics and 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 92.26% of the total revenue dollars but represented 62.38% of the total volume in 2010. Volume differences by customer class for year-to-date 2011 are due to the

[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

seasonal nature of the business. Natural gas cost per dth shows a slight increase from $5.01 in 2009 to $5.34 in 2010.

Questar Corporation owns 100% of the stock in Questar Gas and all of the $7.575 million quarterly dividend will be paid to Questar Corporation. The total amount of the dividends paid to the parent company in 2010 was $28.8 million. The 2010 payout ratio was 65.6%, which is lower than the historical average of 69.5%. 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 large dividend payments could become an issue if there is a downward trend in the overall profitability. At the present time, Questar Gas has adequate cash flow to maintain its service obligations and meet its financial needs.

The Company is projected to maintain profitability levels similar to historical results and 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 $7,575,000 common stock 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.

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