



FitchRatings

Thought Leaders Series — Credit Rating Agencies

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Topics

Credit Rating Agency Role and Process

U.S. Utilities, Power and Gas (UPG) Sector
Outlook

Key Rating Considerations

California Overview

Credit Rating Overview

- Credit Rating Agency Role/Process
 - Independent View of Credit Fundamentals
 - Commentary and Research
 - Forward-Looking Credit Opinions Based on Expected Credit Behavior
 - Standardized Process Governed by Criteria
 - Designed to Ensure Global Consistency
 - Committee Process

Credit Rating Overview

- What Are Credit Ratings?
 - Probability of Default = Issuer Default Rating (IDR)
 - Loss Given Default = Recovery Rating (RR)
 - RRs Are the Bridge Connecting Fitch's IDR and Security Ratings
- Sector Security Ratings Typically Notched Up From IDR
 - Unsecured +1
 - Secured +2

UPG Sector/Business-Specific Key Credit Factors

- Regulation — Transparency, Predictability, Timeliness
- Market and Franchise — Customer Mix, Service Territory Economy
- Asset Base and Operations — Infrastructure Quality, Reliability, Fuel Mix
- Commodity Exposure — Mitigated by Wide Adoption of Pass-Through Mechanisms and Generally Low Pricing

Financial Risk Profile

- Financial Structure/Profitability
- Financial Flexibility
- Financial Ratios

Financial Structure: Sub-Factors

Midpoints	Lease-Adjusted FFO Gross Leverage (x)	Total Adjusted Debt/ Operating EBITDAR (x)
'a' Category	3.50	3.25
'bbb' Category	5.00	3.75
'bb' Category	6.50	4.75
'b' Category	7.00	6.00

Source: Fitch.

Financial Flexibility: Sub-Factors

Midpoints	Financial Discipline	Liquidity	FFO Fixed-Charge Cover (x)
'aa' Category	Publicly announce conservative financial policy. Track record of strict compliance.	Very comfortable liquidity; no need to use external funding in the next 24 months. Well-spread debt maturity. Diversified sources of funding.	N.A.
'a' Category	Clear commitment to maintain a conservative policy with only modest deviations allowed.	Very comfortable liquidity. Well-spread maturity schedule of debt. Diversified sources of funding.	5.0
'bbb' Category	Less conservative policy, but generally applied consistently.	One-year liquidity ratio above 1.25x. Well-spread maturity schedule of debt but funding may be less diversified.	4.5
'bb' Category	Financial policies in place, but flexibility in applying it could lead to temporary exceeding downgrade guidelines.	Liquidity ratio around 1.0x. Less smooth debt maturity or concentrated funding.	3.5
'b' Category	No financial policy or track record of ignoring it. Opportunistic behaviour.	Liquidity ratio below 1.0x. Overly reliant on one funding source.	2.0

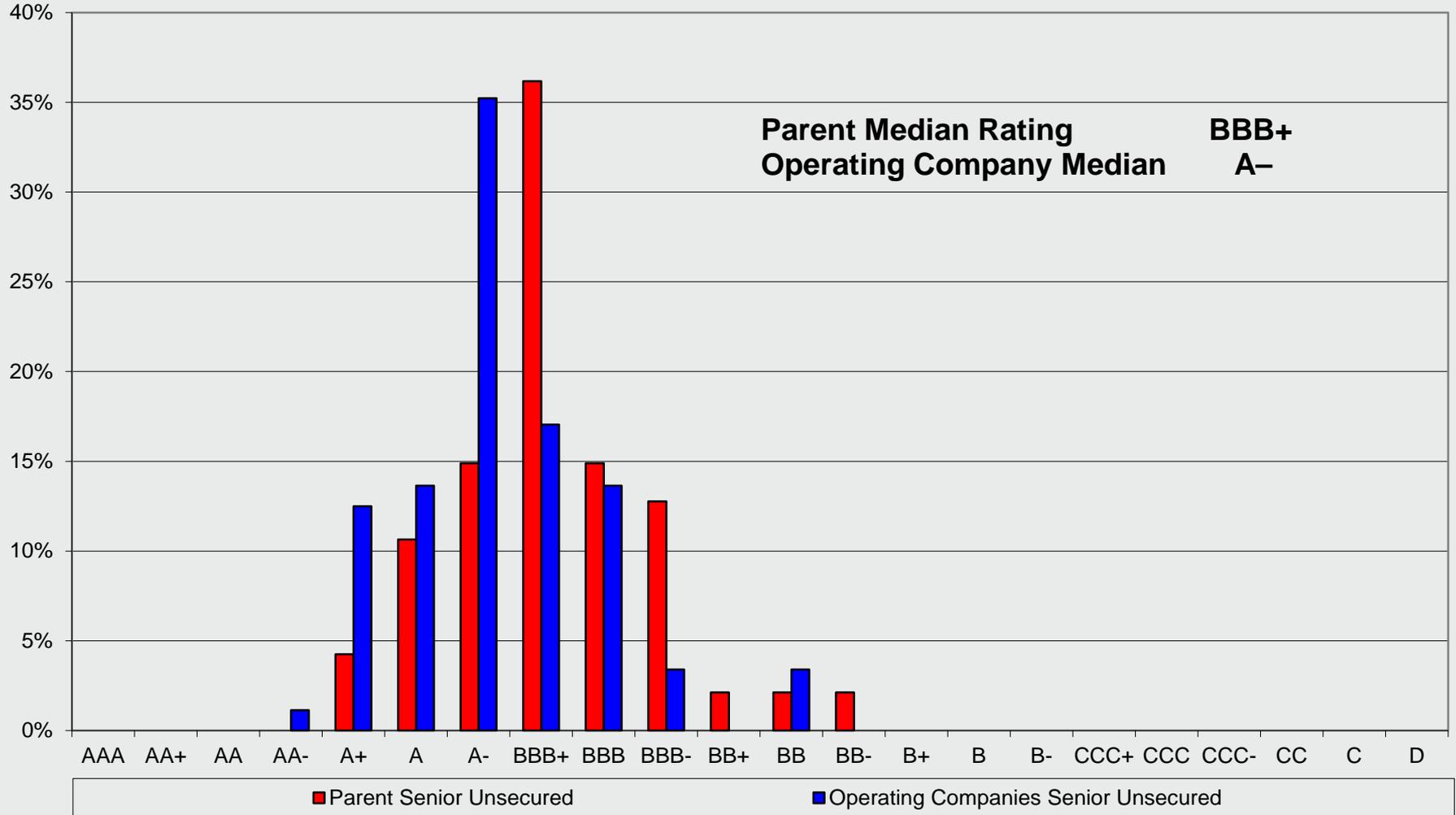
N.A. – Not applicable.
Source: Fitch.

Fitch Utility, Power and Gas Sector Ratings

- Solid Investment-Grade Credit Ratings
- Senior Unsecured Rating Medians
 - Utility Parent Companies (UPC): 'BBB+'
 - Integrated Utility Companies (IUC): 'BBB+'
 - Utility Distribution Companies (UDC): 'BBB+'
 - 87% of Issuer Outlooks Stable
- Relatively Low-Risk Business Model

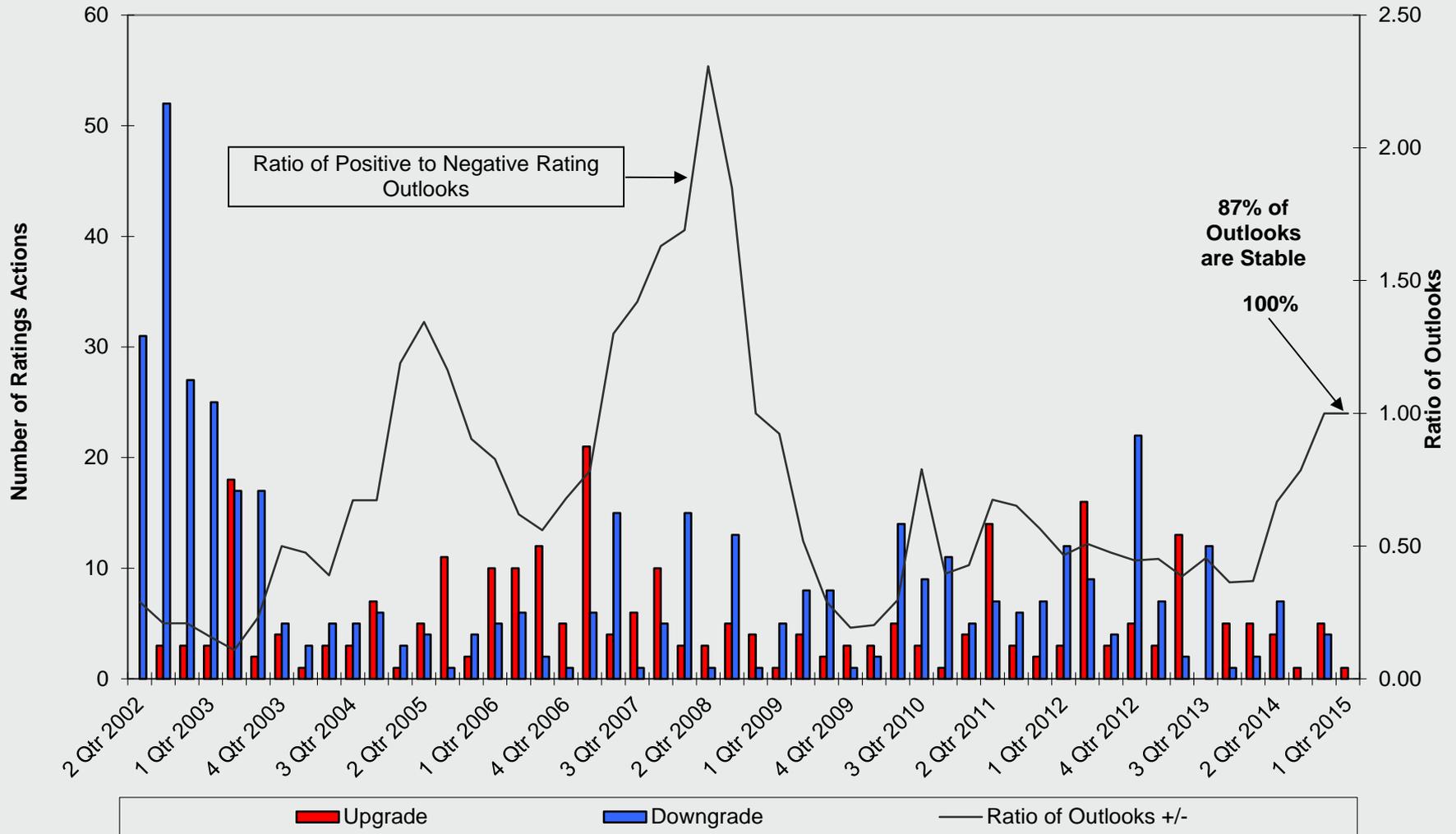
Ratings Distributions of Senior Unsecured Debt Corporate Parents Versus Operating Companies

March 31, 2015



Quarterly Upgrades and Downgrades and Ratio of Positive to Negative Outlooks

2002–2015, as of March 31, 2015



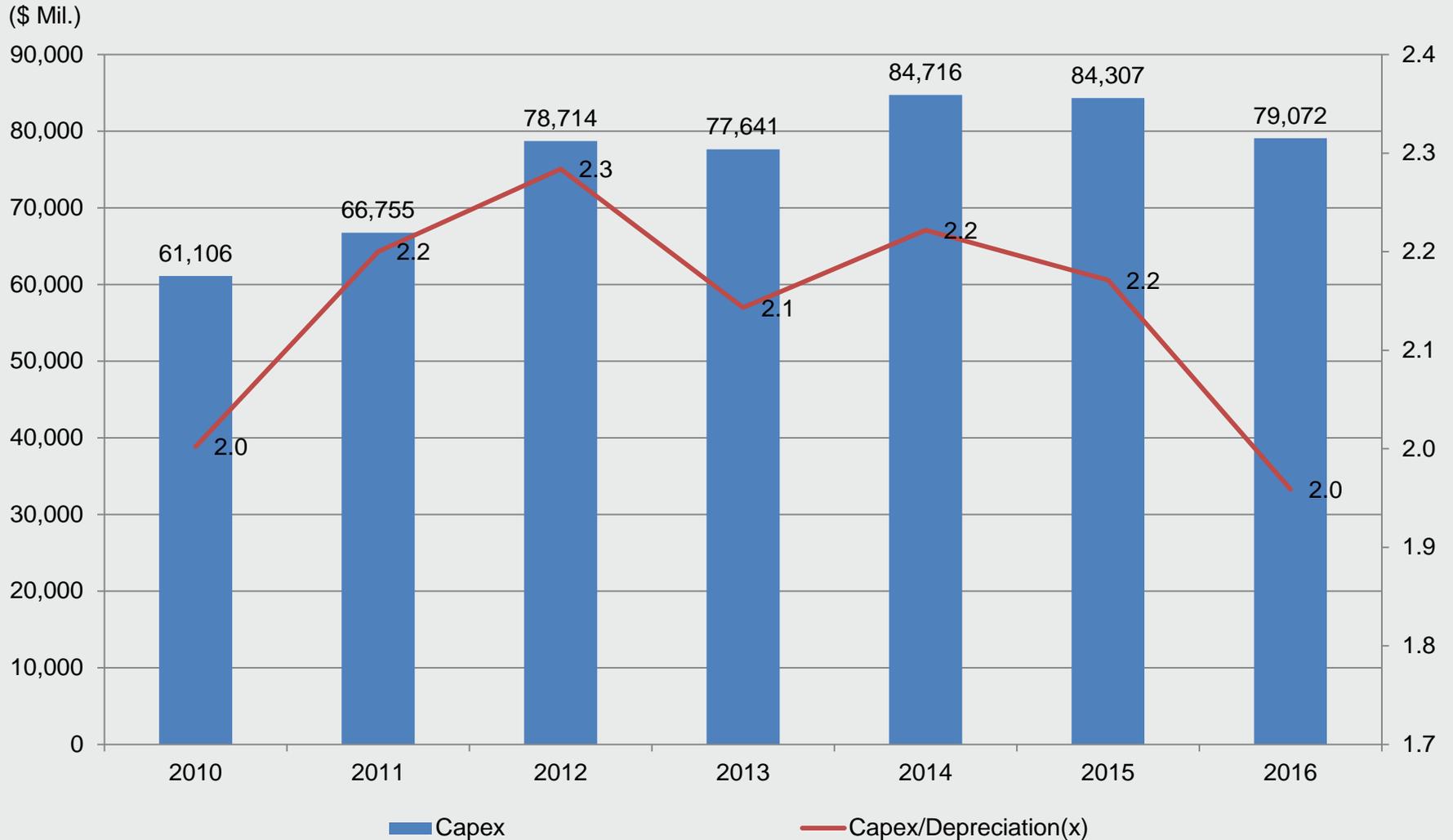
Fitch Utility, Power and Gas Outlook

- UPC: Stable
- IUC and UDC: Stable
- Competitive Generation Company Outlook: Negative

Key Industry Issues

- Climate Change
- Distributed Generation/Energy Efficiency
- High Capex Cycle Driven by Infrastructure Modernization and Replacement
- Power Plant Emission Rules and Regulations
- Regulatory/Legislative Environment
- Low Natural Gas Prices, Interest Rates and Inflation
- Industry Consolidation

Historic and Projected UPG Capex and Depreciation-to-Capex (2010–2016)



Factors Driving Capex

- Climate Change
- Emerging Technologies/Energy Policy
- Aging Distribution System
- Safety
- Reliability

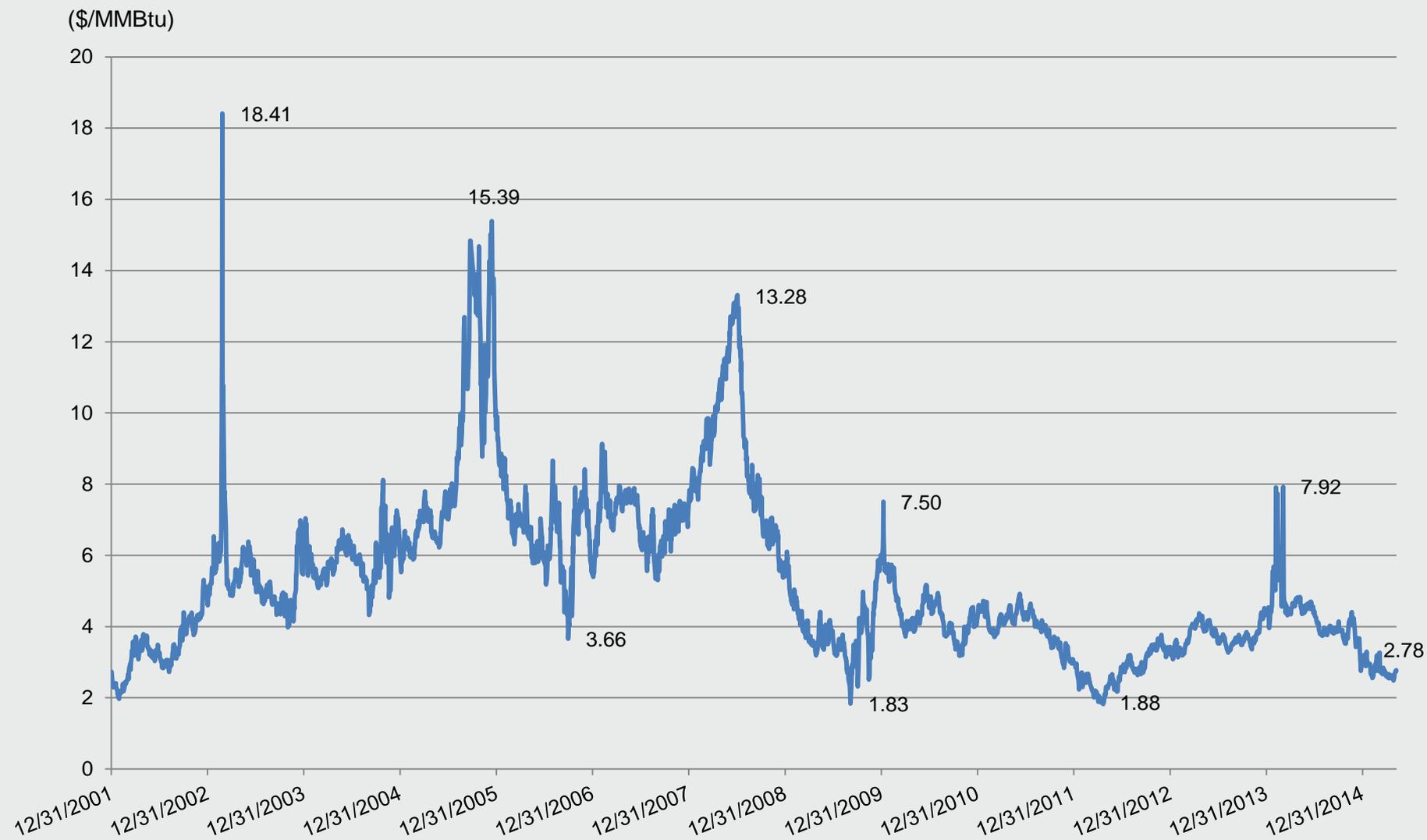
Cost Recovery

- Regulatory Compact
 - Moving Costs Out of GRC Proceedings
 - Trackers, Surcharges, Deferral Mechanisms
 - Weather Normalization, Decoupling, Fixed Versus Variable Rates
 - Authorized Versus Earned Return on Equity
- Energy Policy/Legislative Initiatives

Shale Plays: A Game Changer

- Abundant Supply = Low Natural Gas Prices
- 100-Year Supply
- Positive for Utilities

Henry Hub Daily Spot Price 12/31/01–5/8/15



Natural Gas Price Overview

Natural Gas Price Forecasts (\$/MMBtu)	2015P	2016P	2017P	Long Term
Fitch Base Case	3.00	3.25	3.75	4.50
Fitch Stress Case	2.75	2.75	3.00	3.25
Wood Mackenzie Base Case (Nominal)	3.72	3.70	3.79	N.A.
Wood Mackenzie Base Case (Real)	3.65	3.55	3.57	N.A.
NYMEX Curve Henry Hub (5/8/15)	3.02	3.23	3.38	N.A.

MMBtu – Million British thermal units. P – Projected. N.A. – Not available.
Source:Fitch Ratings, Wood Mackenzie, Bloomberg.

California Overview

- Key Credit-Supportive Features
 - Decoupling
 - Forward Looking Test Years and Attrition Rate Increases
 - Bifurcation of General Rate Case and Cost of Capital
 - Tracking Mechanisms For Key Expenses: ERRRA, etc.
 - Pre-Approval of Capex
 - Single-Issue Rate Case Filings

California Overview

- Concerns
 - Above Industry Average Rates
 - Upward Pressure on kWh Rates Driven by High Capex and Other Factors
 - Green House Gas Initiatives
 - Net Energy Metering
 - RPS
 - Competitive Pressure From Emerging Technologies

California IOU Ratings Summary

Name	IDR	Senior Secured Rating	Senior Unsecured Rating	Short Term Rating	Outlook/ Watch
Pacific Gas and Electric Co.	BBB+	—	A-	F2	Stable
Southern California Edison Co.	A-	A+	A	F1	Stable
San Diego Gas & Electric Co.	A	AA-	A+	F1	Stable
Southern California Gas Co.	A	AA-	A+	F1	Stable

Southern California Edison Navigator

FitchRatings

Southern California Edison Company

Corporates Ratings Navigator
US Utilities

Corporates Ratings Navigator		Factor Levels	Sector Risk Profile	Operating Environment	Management and Corporate Governance	Regulation	Business Profile	Asset Base and Operations	Commodity Exposure	Profitability	Financial Structure	Financial Flexibility	Issuer Default Rating
Publish Date:	27-Feb-15	aaa											AAA
Sector Details:		aa+											AA+
Sector:	US Utilities	aa											AA
Region:	Developed Markets - Americas	aa-											AA-
Country:	United States of America	a+											A+
Country IDR:	AAA Stable	a											A
Country IDR Action:	Affirmed	a-											A-
Country Action Date:	19-Sep-14	bbb->											A- Stable
Country Ceiling:	AAA	bbb											BBB+
Ratings History		bbb-											BBB
Date	IDR	Action											BBB-
1-Oct-14	A-	Stable	Affirmed										BB+
4-Jun-14	A-	Stable	Affirmed										BB
21-Feb-14	A-	Stable	Affirmed										BB-
8-Jan-14	A-	Stable	Affirmed										B+
10-Jan-13	A-	Stable	Affirmed										B
24-Apr-12	A-	Stable	Affirmed										B-
30-Jun-11	A-	Stable	Affirmed										CCC
Bar Chart Legend:		cc											CC
Vertical Bars = Range of Rating Factor		c											C
Bar Colors = Relative Importance		d or rd											D or RD
Higher Importance (Red)													
Average Importance (Blue)													
Lower Importance (Light Blue)													
Bar Arrows = Rating Factor Outlook													
↑ Positive													
↓ Negative													
↕ Evolving													
□ Stable													

Direct Peer Group			
Company Name	IDR	Action	Action Date
Pacific Gas & Electric Company	BBB+	Stable	Affirmed 01-Oct-2014
San Diego Gas & Electric Co.	A	Stable	Affirmed 01-Oct-2014
Arizona Public Service Co.	BBB+	Positive	Affirmed 01-Oct-2014
Nevada Power Company dba NV Energy	BBB	Stable	Affirmed 03-Oct-2014

Drivers & Sensitivities	
Balanced Regulatory Environment	SCE benefits from a balanced regulatory compact in California that includes forward-looking test years, bifurcated cost-of-capital proceedings, revenue decoupling and riders for recovery of key recurring expense items.
Pending GRC	Fitch expects a final regulatory decision in SCE's pending 2015 general rate case (GRC) later this year. Fitch anticipates a final decision consistent with its 2012 GRC, which approved approximately 54% of its 2012-2014 revenue request.
SONGS Settlement Approved	The California Public Utilities Commission's (CPUC) decision approving the modified stipulation addressing San Onofre Nuclear Generating Station (SONGS) cost recovery is a constructive development that removes a source of uncertainty.
Regulatory Ring Fencing	Strong regulatory ring-fencing provisions in the state of California mitigate SCE's rating linkage with its corporate parent, Edison International.
Positive Rating Sensitivities	Balanced regulation and energy policy in California, especially with regard to distributed generation and rate design issues, are key to SCE's creditworthiness. Sustained leverage of 3.25x or better could support future upgrades.
Negative Rating Sensitivities	Deterioration of SCE's regulatory compact, capex cost overruns, competitive inroads from alternative technologies or other factors that cause SCE's EBITDA leverage to weaken to worse than 3.6x could result in future downgrades.

Analysts	
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People in pursuit of answers

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