



Credit Ratings: What They Are, Why They Matter

CALIFORNIA PUBLIC UTILITIES COMMISSION THOUGHT LEADERS SERIES

Agenda

1. What Ratings Are, Why They Matter
2. How Ratings Are Produced
3. What Ratings Mean For Californians

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What Ratings Are, Why They Are Important

Ratings: What They Are, Why They Are Important

What They Are

- » Independent, objective assessments of the relative creditworthiness of debt obligations
- » Shorthand symbols denoting the relative ability and willingness of debt issuers to make full and timely payment
- » Opinions about future potential risks

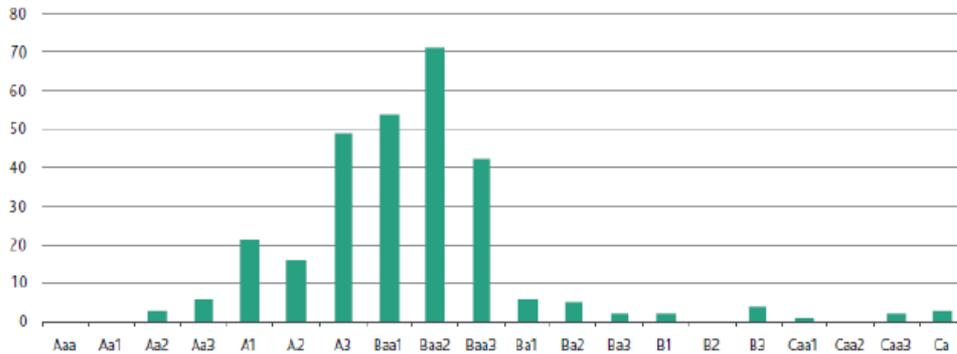
Why They Are Important for Utilities

- » Capital-intensive business requires constant debt issuance
- » Ratings make debt securities more liquid
- » Investment grade ratings provide better access to capital, lower cost of capital, lower rates for customers

Utilities Are Highly Rated

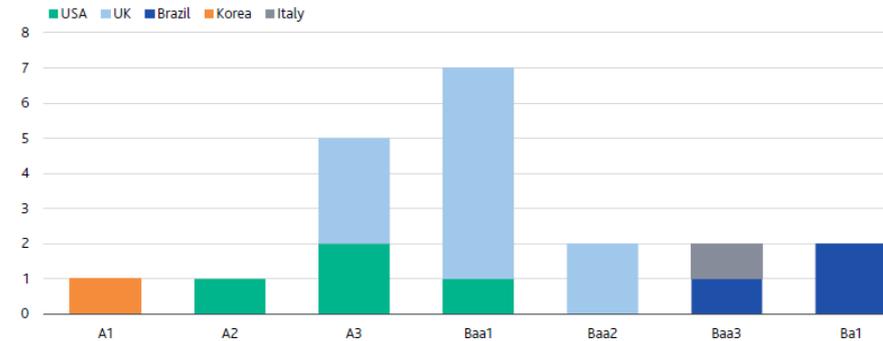
- » Investment grade ratings indicate stability from regulation
- » Reflect better history of default and recovery rates than those in competitive industrial sectors
- » Average ratings: US utilities Baa1, water utilities A3, California utilities A2*

Global Electric & Gas Utility Ratings Distribution



Source: Moody's

Global Water Utility Ratings Distribution



*Average of San Diego Gas & Electric (A1), Southern California Gas (A1), Southern California Edison (A2), Pacific Gas & Electric (A3)

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How Ratings Are Produced

Utility Rating Methodology: Regulation Most Important

- » Regulation accounts for half the rating, influences the other factors
 - » Profitability, diversity dominate for unregulated competitive industries

Factor / Sub-Factor Weighting - Regulated Utilities

Broad Rating Factors	Broad Rating Factor Weighting	Rating Sub-Factor	Sub-Factor Weighting
Regulatory Framework	25%	Legislative and Judicial Underpinnings of the Regulatory Framework	12.5%
		Consistency and Predictability of Regulation	12.5%
Ability to Recover Costs and Earn Returns	25%	Timeliness of Recovery of Operating and Capital Costs Sufficiency of Rates and Returns	12.5% 12.5%
Diversification	10%	Market Position	5%*
		Generation and Fuel Diversity	5%**
Financial Strength, Key Financial Metrics	40%	CFO pre-WC + Interest / Interest	7.5%
		CFO pre-WC / Debt	15.0%
		CFO pre-WC – Dividends / Debt	10.0%
		Debt/Capitalization	7.5%
Total	100%		100%

Factor 1A: Improvement in US regulatory environment vs. jurisdictions in other countries led to upgrades of most US utilities in 2014; A score for most and for CA*

Factor 1B: Utility-specific regulatory treatment; scores range Aa-Baa; A for most; A average for CA*

Factor 2A: Rate case process, cost recovery mechanisms, regulatory lag; scores range Aa-Ba, A for most; Aa average for CA*

Factor 2B: ROE (allowed vs. industry average and actual earned), disallowances; scores range from Aa to Ba, Baa for most and for CA*

Factor 4: Financial metrics accounts for majority in competitive industries
Cash flow from operations before working capital changes (CFO pre-WC)-to-debt ratios most important

*Average of San Diego Gas & Electric (A1), Southern California Gas (A1), Southern California Edison (A2), Pacific Gas & Electric (A3)

Supportive Regulation Leads to Stronger Credit Metrics

- » Strong factors 1B, 2A, 2B scores correlate to stronger CFO Pre WC/Debt
- » California utilities average 29% CFO Pre WC/Debt

Factor 1B
Consistency, Predictability
of Regulation

Factor 2A
Timeliness of Recovery
of Costs

Factor 2B
Sufficiency of Rates and
Returns

Score	CFO Pre WC/Debt	Score	CFO Pre WC/Debt	Score	CFO Pre WC/Debt
Aa	24%	Aa	24%	Aa	18%
A	22%	A	22%	A	23%
Baa	20%	Baa	20%	Baa	22%
Ba	15%	Ba	N/A	Ba	19%

Source: Moody's FM

- » Low CFO pre WC/Debt ratio for Aa score in Factor 2B an outlier due to low-risk T&Ds that have lower but more stable returns and CFO

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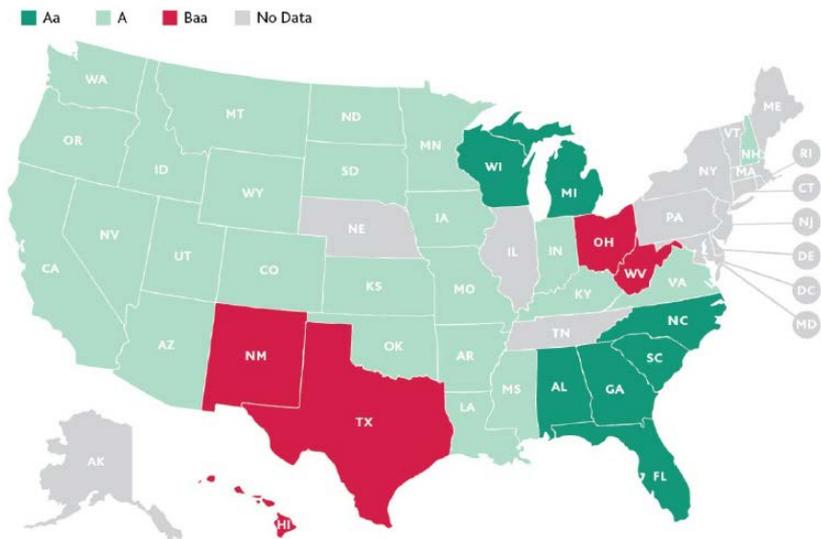
What Ratings Mean For Californians

Strong Ratings: Better Access to Capital at Lower Cost

- » California utilities need to finance \$24B of capex (2x depreciation) and refinance +\$1B of maturing debt in 2015-16
- » Investors and utilities make decisions on where they want to invest

Consistency, Predictability of Regulation (Factor 1B)

Vertically Integrated Utilities - Average Factor 1B Score



Source: Moody's

What Utility Ratings Mean For Californians

- » California utilities need to raise large amount of capital to fund their capex
- » Ratings make debt securities more liquid
- » Investment grade ratings provide better access to capital, lower cost of capital, lower rates for customers

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