MOODY'S INVESTORS SERVICE

Credit Opinion: FortisBC Energy Inc.

Global Credit Research - 04 Oct 2012

Vancouver, British Columbia, Canada

Ratings

Category	Moody's Rating
Outlook	Stable
Senior Secured -Dom Curr	A1
Senior Unsecured -Dom Curr	A3
Parent: FortisBC Holdings Inc.	
Outlook	Stable
Senior Unsecured -Dom Curr	Baa2
FortisBC Energy (Vancouver Island) Inc.	
Outlook	Stable
Senior Unsecured -Dom Curr	A3

Contacts

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Key Indicators

[1]**FortisBC Energy Inc.**

	[2]LTM	2011	2010	2009	2008	2007
(CFO Pre-W/C + Interest) / Interest Expense	2.9x	2.8x	2.7x	2.6x	2.5x	2.4x
(CFO Pre-W/C) / Debt	11.6%	11.2%	10.6%	10.2%	9.8%	8.8%
(CFO Pre-W/C - Dividends) / Debt	7.1%	6.5%	5.9%	6.5%	4.2%	2.5%
Debt / Book Capitalization	47.3%	59.3%	59.1%	61.8%	68.4%	66.8%

[1] All ratios calculated in accordance with Moody's Regulated Electric and Gas Utilities Rating Methodology using Moody's standard adjustments. In addition, Moody's adjusts for one-time items. [2] Last twelve months ended June 30, 2012 reflect changes to US-GAAP whereas prior years are reported under Canadian GAAP. Goodwill is included on FEI's balance sheet with the most notable impact on Debt/Book Capitalization ratios

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

Low-risk, cost-of-service regulated gas transmission and distribution utility

Relatively weak financial metrics balanced by a supportive regulatory environment

Potential amalgamation of FortisBC Energy Inc. with its sister LDCs

Strong regulatory ring-fencing mechanisms insulate company from its parent holding company

Good liquidity

Corporate Profile

FortisBC Energy Inc. (FEI) is the largest distributor of natural gas in British Columbia and one of the largest gas local distribution companies (LDC) in Canada. FEI is regulated on a cost-of-service basis by the British Columbia Utilities Commission (BCUC).

FEI is a wholly-owned subsidiary of FortisBC Holdings Inc. (FHI) which, in turn, is a wholly-owned subsidiary of Fortis Inc. (FTS, not rated), a diversified electric and gas utility holding company. FHI is a holding company which also holds 100% of FortisBC Energy (Vancouver Island) Inc. (FEVI) and FortisBC Energy (Whistler) Inc. (FEW).

SUMMARY RATING RATIONALE

FEI's A3 senior unsecured rating and stable outlook reflect its low-risk LDC business model and the generally supportive regulatory environment offset by its relatively weak financial metrics. We recognize that the weakness of FEI's financial metrics relative to similarly rated U.S. peers is largely a function of the lower deemed equity and ROE permitted by the BCUC. We believe that FEI's weak financial profile is balanced by its relatively low business risk as a gas LDC and by the supportiveness of regulatory environments in Canada generally and in British Columbia specifically. Regulatory ring-fencing mechanisms effectively insulate FEI from its parent company, FHI, and FTS. Growth in FEI's franchise area tends to be relatively predictable and capital spending is not expected to tax the company's resources. FEI maintains sufficient liquidity resources.

DETAILED RATING CONSIDERATIONS

LOW-RISK REGULATED GAS DISTRIBUTION UTILITY OPERATING IN A SUPPORTIVE ENVIRONMENT

In general, we consider gas LDCs to be at the low end of the risk spectrum within the universe of regulated utilities. Similarly, we believe that regulated utilities, which are permitted the opportunity to recover their costs and earn an allowed return, have lower business risk than unregulated companies that do not benefit from cost of service regulation. Accordingly, we consider regulated gas LDCs like FEI to be among the lowest risk corporate entities.

The supportiveness of the BC regulatory environment is evidenced by the fact that FEI benefits from the existence of a number of BCUC-approved deferral, or true up, mechanisms. These mechanisms limit FEI's exposure to forecast error with respect to commodity price and volume, pension funding costs, insurance costs and short-term interest rates. In addition, FEI is required to obtain a certificate of public convenience and necessity (CPCN) from the BCUC prior to undertaking any capital project in excess of $5 million. In our view, this process reduces the risk that FEI would be denied the opportunity to recover the cost of its capital investments. We believe these qualitative factors balance FEI's weak financial profile.

Growth in FEI's franchise area tends to be relatively predictable and capital spending is generally stable and modest in the context of FEI's asset base and depreciation expense.

FINANCIAL METRICS EXPECTED TO STRENGTHEN MODESTLY IN 2012 and 2013

FEI's financial metrics are materially weaker than those of its A3 rated global gas utility peers such as Piedmont Natural Gas Company, Inc., Northwest Natural Gas Company, UGI Utilities and its sister company, FEVI. We recognize that FEI's weaker financial metrics are largely a function of the deemed equity and allowed ROE approved by the BCUC. In general, Canadian deemed equity ratios and allowed ROEs are low relative to those of other jurisdictions.

We expect FEI's cash flow to increase in 2012 and 2013 due to higher levels of non-cash depreciation and amortization expense that will be collected in revenues. The largest driver of the higher depreciation will be FEI's customer care enhancement project placed into service this year. We anticipate that these changes will cause CFO pre-WC + Interest / Interest (Cash Flow Interest Coverage) to approach 3x in 2012 and 2013. The change in the Debt/Book Capitalization ratio is merely a function of US-GAAP accounting rules as goodwill associated with the Fortis Inc. acquisition in 2007 is now recognized as an asset on FEI's balance sheet with an offset to paid-in capital.

POTENTIAL AMALGAMATION OF FEI, FEVI AND FEW LIKELY CREDIT NEUTRAL

FEI applied earlier this year to the BCUC to amalgamate FEI, FEVI and FEW and harmonize rates across the amalgamated utility with a decision expected in early 2013. In an amalgamation scenario, the senior unsecured debt of FEI and FEVI would rank pari passu and be supported by the combined cash flow of the amalgamated utility. We expect that amalgamation and rate harmonization would be credit neutral to FEI provided that there are no reductions in deemed equity levels or allowed ROEs or increases in the fundamental business risks borne by the amalgamated utility.

STRONG REGULATORY RING-FENCING INSULATES FEI FROM PARENT, FHI

We believe that FEI's ring-fencing is very strong relative to that of its peers outside of BC. FEI is subject to a set of regulatory ring-fencing conditions imposed by the BCUC. The ring-fencing conditions provide that, unless otherwise approved by the BCUC, FEI shall: maintain a ratio of common equity to total capital at least as high as the deemed equity capitalization utilized by the BCUC for ratemaking purposes (currently 40%); not pay dividends if they would cause FEI's common equity to total capital to fall below the BCUC's deemed equity percentage; not invest in or financially support non-regulated business; and not engage in affiliate transactions on anything other than an arm's length basis. We believe that the BCUC ring-fencing provisions effectively insulate FEI from the financial and business risks of its parent, FHI, and FTS. The regulatory ring-fencing provisions, combined with FTS' philosophy of requiring its utility operating subsidiaries to be operationally and financially independent of FTS and other subsidiaries, allows us to evaluate FEI's credit profile on a stand-alone basis.

Liquidity Profile

We consider FEI's liquidity resources to be good at the end of Q2 2012.

FEI is expected to generate approximately $240 million of CFO pre-WC during the 12 months ending June 30, 2013. After dividends in the range of $85 million and capital expenditures and working capital changes of approximately $200 million, we expect FEI to be free cash flow (FCF) negative by approximately $45 million. FEI has no material scheduled debt maturities during the next twelve months..

At the end of Q2 FEI had $449 million available under its $500 million syndicated credit facility, well in excess of our estimated funding requirement.

The $500 million facility is available to support FEI's $500 million commercial paper (CP) program and for general corporate purposes. The company is currently well below the debt to total capitalization ratio covenant (maximum 75%) in the credit agreement.

We recognize that FEI's reliance on short-term debt to finance gas inventories is supported by the BCUC and that the BCUC has approved the use of an interest rate deferral account to limit FEI's exposure to short-term interest rate volatility. However, we believe that FEI's financial flexibility can become somewhat constrained, particularly when material debt maturities fall within the peak storage season. Although FEI has no significant debt maturities until September 2015, the BCUC's July 2011 decision to eliminate the majority of FEI's commodity hedging activities is expected to increase the volatility of FEI's cash flow and increase FEI's liquidity requirements. This decision is directionally negative for credit but, at this time, not material enough to impact our rating or outlook.

Rating Outlook

The stable rating outlook reflects our expectation of stable operating results and our belief that FEI's regulatory environment will continue to be supportive. The outlook also reflects our belief that if FEI, FEVI and FEW ultimately amalgamate, the amalgamation and rate harmonization would be credit neutral for FEI's credit profile.

What Could Change the Rating - Up

The rating could be positively impacted if FEI demonstrates a sustainable improvement in its credit metrics. All else being equal, at the A2 senior unsecured level, Moody's would expect FEI's Cash Flow Interest Coverage to exceed 4x and CFO pre-WC / Debt to be above 19% on a sustainable basis.

What Could Change the Rating - Down

Notwithstanding FEI's low risk business profile, its financial profile is considered relatively weak at the A3 senior unsecured rating level. Accordingly, a sustained weakening of FEI's Cash Flow Interest Coverage below 2.3x and CFO pre-WC / Debt below 8% combined with a less supportive and predictable regulatory framework would likely result in a downgrade of FEI's rating.

Rating Factors

FortisBC Energy Inc.

Regulated Electric and Gas Utilities Industry [1][2]	**Current**		**[3]Moody's 12-18 month Forward View As of September 2012**	
Factor 1: Regulatory Framework (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Regulatory Framework		A		A
Factor 2: Ability To Recover Costs And Earn Returns (25%)				
a) Ability To Recover Costs And Earn Returns		A		A
Factor 3: Diversification (10%)				
a) Market Position (10%)		A		A
b) Generation and Fuel Diversity (0%)				
Factor 4: Fin. Strength, Liquidity And Key Fin. Metrics (40%)				
a) Liquidity (10%)		A		A
b) CFO pre-WC + Interest/ Interest (3 Year Avg) (7.5%)	2.8x	Baa	2.8x-3.0x	Baa
c) CFO pre-WC / Debt (3 Year Avg) (7.5%)	12%	Ba	11% - 13%	Ba
d) CFO pre-WC - Dividends / Debt (3 Year Avg) (7.5%)	7%	Ba	7% - 9%	Ba
e) Debt/Capitalization (3 Year Avg) (7.5%)	53%	Baa	48% - 50%	Ba
Rating:				
a) Indicated Baseline Credit Assessment from Methodology Grid		A3		A3
b) Actual Baseline Credit Assessment Assigned				A3

Source: Moody's Financial Metrics.

[1] All ratios calculated in accordance with Moody's Regulated Electric and Gas Utilities Rating Methodology using Moody's standard adjustments. In addition, Moody's adjusts for one-time items. [2] Last twelve months ended June 30, 2012 [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.

Notwithstanding the foregoing, credit ratings assigned on and after October 1, 2010 by Moody's Japan K.K. (“MJKK”) are MJKK's current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. In such a case, “MIS” in the foregoing statements shall be deemed to be replaced with “MJKK”. 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.

This 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 investors. It would be dangerous for retail investors to make any investment decision based on this credit rating. If in doubt you should contact your financial or other professional adviser.