

Standard & Poor's
“Utilities & Perspectives”
June 21, 1999



Standard & Poor's UTILITIES & PERSPECTIVES

INSIDE

- 4 **A Conversation With**
Standard & Poor's
Global Utilities Rating
Service Managing
Director
- 6 **News Comments**
- 6 Ratings on South Western
Electricity and London
Electricity Affirmed
- 6 Northeast Utilities'
Units' Ratings Affirmed
- 6 Illinova and Dynegy
Agree to Merge
- 7 Citizens Utilities' Ratings
Remain On Watch Neg
- 7 NYSEG Placed On Watch
Neg, Central Maine On
Watch Pos After Merger
Announcement
- 8 Southern Indiana GE Placed
On Watch Neg; Indiana
Energy and Indiana Gas On
Watch Pos
- 8 **Last Week's Rating Reviews**
- 9 **Last Week's Financing
Activity**
- 9 Gener's Debentures Are
Rated
- 9 PowerGen U.K.'s Bonds
Are Rated
- 10 **Utility Credit Rankings**

STANDARD
& POOR'S

Utility Financial Targets Are Revised

Standard & Poor's has revised the four principal financial targets that it uses to analyze the credit quality of all investor-owned electric, natural gas, and water utilities in the U.S. (see table on page 3).

Standard & Poor's has created a single set of financial targets that can be applied across the different utility segments. These financial measures reflect the convergence that is occurring throughout the utility industry and the changing risk profile of the industry in general.

No rating changes will result from establishing these new financial targets since they were developed by integrating prior utility financial benchmarks and historical industrial medians. The new financial targets, like the previous benchmarks, pertain to risk-adjusted ratios that distinguish between lower-risk and higher-risk activities. The targets have been broadened to correspond with Standard & Poor's 10-point business profile assessments. The business profile scores assess the qualitative attributes of a firm, with "1" being considered lowest risk and "10" highest risk. Thus, the new targets allow for comparability on a single scale between typically lower-risk activities, such as water operations, gas distribution, and electric transmission, and higher-risk activities, such as merchant power generation, oil and gas exploration and production, and energy trading and marketing. For example, a water utility, which can expect to have a lower business risk profile than a typical integrated electric utility, will be required to meet less stringent financial targets for any given rating category.

Funds from operations to total debt, funds from operations interest coverage, pretax interest coverage, and total debt to total capital are the four credit-protection ratios that are an integral part of

Standard & Poor's quantitative review on the overall credit analysis of the utility sector. Standard & Poor's recognizes that the nature of utilities' business strategies is changing significantly and is shifting toward higher-risk endeavors. These undertakings bear risk characteristics that are more representative of an industrial company than a regulated utility. Therefore, Standard & Poor's also incorporates a greater reliance on several additional ratios in its credit analysis. These include, but are not limited to, pretax return on permanent capital, funds from operations to current obligations, earnings before interest and taxes to total assets, net cash flow to capital expenditures, and capital expenditures to average total capital. Additionally, further analysis of the cash flow coverage of all obligations (including preferred stock) is performed. Although these measures do not have published targets, broader use of these financial ratios, combined with the four principal targets, provides greater depth to the fundamental analysis used in the rating evaluation process.

Consistent with Standard & Poor's ratings methodology, the four published financial targets will be used with other quantitative measures, business risk analysis, and comparative analysis of peer groupings to determine credit ratings. The new targets are designed to assist utilities, utility affiliates, and the investment community in assessing the relative financial strength of issuers. ■

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(continued on page 3)

UTILITY SPOTLIGHT

AEP/CSW Merger May Close by Year End page 2



COVER STORY

(continued from page 1)

Revised Utility Group Financial Targets*

FFO to total debt

Business position

1
2
3
4
5
6
7
8
9
10

	"AA"		"A"		"BBB"		"BB"		"B"	
1	20.0	16.5	16.5	12.5	12.5	7.0	<7.0	-	-	-
2	25.0	21.0	21.0	16.0	16.0	10.5	<10.5	-	-	-
3	31.5	26.0	26.0	20.0	20.0	14.0	14.0	9.5	9.5	4.0
4	36.5	30.5	30.5	24.5	24.5	17.5	17.5	12.0	12.0	6.0
5	40.0	33.0	33.0	27.0	27.0	20.5	20.5	15.0	15.0	7.5
6	47.0	39.0	39.0	31.0	31.0	22.0	22.0	16.0	16.0	8.5
7	56.0	47.0	47.0	36.5	36.5	24.5	24.5	17.0	17.0	9.5
8	66.0	55.0	55.0	42.5	42.5	27.5	27.5	18.5	18.5	11.0
9	-	-	64.5	49.5	49.5	32.0	32.0	22.0	22.0	12.5
10	-	-	78.0	60.5	60.5	39.0	39.0	28.0	28.0	17.5

FFO interest coverage

Business position

1
2
3
4
5
6
7
8
9
10

	"AA"		"A"		"BBB"		"BB"		"B"	
1	3.1	2.6	2.6	1.9	1.9	0.9	<0.9	-	-	-
2	3.9	3.3	3.3	2.5	2.5	1.5	<1.5	-	-	-
3	4.5	3.9	3.9	3.1	3.1	2.1	2.1	1.3	1.3	0.5
4	5.1	4.5	4.5	3.8	3.8	2.7	2.7	1.8	1.8	0.9
5	5.4	4.8	4.8	4.0	4.0	3.0	3.0	2.1	2.1	1.1
6	6.6	5.7	5.7	4.5	4.5	3.1	3.1	2.2	2.2	1.2
7	8.4	7.0	7.0	5.1	5.1	3.3	3.3	2.3	2.3	1.3
8	10.2	8.3	8.3	5.9	5.9	3.5	3.5	2.4	2.4	1.5
9	-	-	9.5	7.1	7.1	4.3	4.3	2.9	2.9	1.8
10	-	-	11.3	8.6	8.6	5.3	5.3	3.6	3.6	2.3

Pretax interest coverage

Business position

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2
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4
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6
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8
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	"AA"		"A"		"BBB"		"BB"		"B"	
1	2.8	2.4	2.4	1.8	1.8	1.8	<0.8	-	-	-
2	3.4	2.9	2.9	2.3	2.3	1.9	<1.3	-	-	-
3	4.0	3.4	3.4	2.8	2.8	1.8	1.8	1.1	1.1	0.3
4	4.6	4.0	4.0	3.3	3.3	2.2	2.2	1.3	1.3	0.5
5	5.0	4.3	4.3	3.5	3.5	2.4	2.4	1.5	1.5	0.6
6	6.2	5.2	5.2	4.0	4.0	2.6	2.6	1.6	1.6	0.7
7	8.0	6.5	6.5	4.7	4.7	2.8	2.8	1.8	1.8	0.9
8	9.9	8.0	8.0	5.5	5.5	3.0	3.0	2.0	2.0	1.1
9	-	-	9.1	6.6	6.6	3.7	3.7	2.5	2.5	1.4
10	-	-	11.1	8.4	8.4	5.0	5.0	3.3	3.3	1.8

Total debt to total capital

Business position

1
2
3
4
5
6
7
8
9
10

	"AA"		"A"		"BBB"		"BB"		"B"	
1	50.5	55.0	55.0	60.5	60.5	67.5	>67.5	-	-	-
2	46.5	51.0	51.0	56.5	56.5	63.5	>63.5	-	-	-
3	42.0	47.5	47.5	53.0	53.0	61.0	61.0	67.0	67.0	74.0
4	37.5	43.0	43.0	49.5	49.5	57.0	57.0	64.0	64.0	72.5
5	36.0	41.5	41.5	47.0	47.0	55.0	55.0	62.5	62.5	71.0
6	32.5	39.5	39.5	46.0	46.0	53.5	53.5	60.5	60.5	69.0
7	30.5	37.5	37.5	45.0	45.0	52.5	52.5	59.5	59.5	68.0
8	28.0	35.0	35.0	43.0	43.0	51.5	51.5	58.0	58.0	66.0
9	-	-	30.0	39.0	39.0	47.5	47.5	54.0	54.0	61.5
10	-	-	24.0	33.0	33.0	40.5	40.5	46.0	46.0	53.0

*As of June 1999. FFO—Funds from operations.

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