Criteria | Corporates | Industrials:

Key Credit Factors For The Midstream Energy Industry

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Key Credit Factors For The Midstream Energy Industry

(Editor's Note: This criteria article supersedes the article titled, "Key Credit Factors: Criteria For Rating The Global Midstream Energy Industry," published on April 18, 2012.)

1. Standard & Poor's Ratings Services is refining and adapting its methodology and assumptions in its key credit factors for the midstream energy industry. We are publishing this article to help market participants better understand the key credit factors in this industry. This article is related to our global corporate criteria (see "Corporate Methodology," published Nov. 19, 2013, on RatingsDirect) and to our criteria article "Principles Of Credit Ratings," which we published on Feb. 16, 2011.


SCOPE OF THE CRITERIA

3. Standard & Poor's is refining its criteria for the global midstream energy industry. By "midstream energy," we mean companies that derive a majority of their revenues from the transporting, processing, storage, and marketing of commodities such as crude oil, refined products (e.g., gasoline and diesel), natural gas, and natural gas liquids (NGLs). The sector connects oil and gas exploration and production (or "upstream") activities with oil refiners and retail marketers (the "downstream" sector), export facilities, utilities, and industrial users. In addition, some midstream operators handle other commodities such as ethanol, ammonia, asphalt, and coal. These criteria do not cover rate-based midstream assets that regulated utilities own. In those cases, our criteria on regulated utilities apply (see "Key Credit Factors For The Regulated Utilities Industry," published Nov. 19, 2013).

SUMMARY OF CRITERIA UPDATE

4. Standard & Poor's is updating its criteria for analyzing midstream energy companies and applying our global corporate criteria.

5. We view midstream energy as a "low-risk" industry under our criteria, given the industry's "intermediate" cyclical性和 "low" competitive risk and growth. In assessing the competitive position of a midstream energy company, we put particular emphasis on the following factors:

- The resiliency of volume flows;
- The contract profile (specifically, the type and length of the contracts and the creditworthiness of counterparties);
- The degree of commodity price exposure; and
- The scale and geographic diversity of operations.
6. In our assessment of a company's financial risk profile, we focus on debt leverage, capital spending, and working capital characteristics (including seasonal shifts).

**IMPACT ON OUTSTANDING RATINGS**

7. We do not expect these criteria, in and of themselves, to result in any rating changes. See our global corporate criteria for the impact on ratings for this industry.

**EFFECTIVE DATE AND TRANSITION**

8. These criteria are effective immediately on the date of publication.

**METHODOLOGY**

**Part I--Business Risk Analysis**

**Industry risk**

9. Within the framework of our global corporate criteria for assessing industry risk, we view midstream energy as a "low-risk" industry (category 2) based on our view of the segment's "intermediate-risk" (3) cyclicality and "low-risk" (2) competitive risk and growth assessment.

10. Key causes of cyclicality in this industry are economic growth, energy price inflation, industrial production, crude oil prices, capacity utilization, and capital spending. Although we view the industry's cyclicality as "intermediate risk," it varies by subsector. Some subsectors are tied very closely to the general economy or commodity cycles, while others are stable. As examples, some long-haul pipelines can have little volatility in supply volumes because of the necessity of serving high-demand centers, while demand for certain gathering pipelines and processing plants is tied closely to industrial production and natural gas and NGL prices.

11. The cyclical nature of capital intensity occurs from demand changes, usually related to industrial production, and incremental additions in capacity. Like many industrial sectors, capacity additions take time to build and can exacerbate economic downturns if the units begin operations when demand begins to drop. However, in the midstream energy sector, companies generally undertake sizable capacity projects only if they have secured long-term contracts, which tend to mitigate revenue volatility.

**Cyclicality**

12. We assess cyclicality for the midstream energy industry as "intermediate risk" (3). The industry has moderate cyclicality—relative to other industries—in both revenue and profitability, the two key measures we look at (see "Methodology: Industry Risk," published Nov. 19, 2013). Based on our analysis of global Compustat data, midstream energy companies have experienced an average peak-to-trough (PTT) decline in revenues of about 15% during recessionary periods since 1972. The steepest decline (53%) occurred during the 2000-2002 recession. The decline during the most recent recession (2007-2009) was 29% and was related mainly to a severe drop in crude oil prices.
average PTT decline in EBITDA margin has been about 10% during recessionary periods, with the steepest PTT drop (19%) during the recession of 1988-1992. The drop during the most recent recession (2007-2009) was 9%.

We generally believe that the higher the cyclicality of profits in an industry, the higher the credit risk of entities operating in that industry. However, the overall effect of cyclicality on an industry's risk profile may be mitigated or exacerbated by the competitive and growth environments.

**Competitive risk and growth**

We view the midstream energy's competitive risk and growth assessment as "low risk" (2). To assess competitive risk and growth, we determine whether the following four sub-factors are low, medium, or high risk:

- Effectiveness of barriers to entry;
- Level and trend of profit margins;
- Risk of secular change and substitution by products, services, and technologies; and
- Growth trends.

Effectiveness of barriers to entry: Low risk.
The high capital intensity creates an effective barrier to entry for new entrants. For instance, some large-scale projects, such as long-haul pipelines, can cost well over $1 billion and take several years to complete, and obtaining necessary rights-of-way and environmental permits may prove daunting. A lack of scale and scope relative to those of established competitors can also inhibit new entrants' ability to attract customers and can hurt their cost structures and ability to obtain cost-effective capital. In some portions of the midstream sector, regulatory oversight and the need for regulatory approval can essentially create monopolies, for instance in long-haul pipelines.

Level and trend of profit margins: Low risk.
The level and trend of profit margins vary widely from one subsector to another, but most midstream energy companies, such as natural gas pipelines, generally have stable profits through different economic conditions and commodity price cycles. However, profit margins in some sectors, such as natural gas processing, are more cyclical, and we factor this into our competitive position assessment. Long-term contracts generally provide a base level of revenue and ensure adequate rates of return, even under adverse market conditions. Take-or-pay contracts are prevalent in the midstream sector and require the customer to make payments regardless of whether they use the assets (i.e., regardless of volume levels or commodity prices). Regulatory frameworks also reduce the risk of lower profits during times of adverse changes to operating costs or throughput levels.

Certain subsectors, e.g., natural gas processing, have greater exposure to commodity prices and competitive forces than other subsectors do. To limit this risk, processing companies typically have contracts ensuring a floor price, which protects them if commodity prices drop below the floor price. Changes in underlying commodity prices can affect industry profitability in two ways—through declining volumes as producers scale back activity in response to weaker margins, and through lower profits on commodity-exposed segments, which receive a percentage of the underlying commodity as compensation. To ensure adequate profitability during periods (or ongoing trends) of low gathering volumes, gathering companies often have contracts for minimum-volume commitments. Competition can also affect profit margins because midstream companies are always seeking to expand into new basins and reduce prices for their services to secure new business.

Risk of secular change and substitution by products, services, and technologies: Low risk.
The risk of product substitution is low for midstream energy companies. Crude oil is an essential commodity for transportation fleets, while natural gas is required for electricity generation and home heating. Pipelines are generally the most efficient and lowest-cost way to transport hydrocarbons, which limits the risk of substitution by other methods such as truck and...
rail. Alternative fuel sources (e.g., ethanol as a transportation fuel and wind to generate electricity) could disrupt competition in the very long term, but we think the potential effect of such substitutions will be relatively minor for the next several years, if not decades.

19. **Risk in growth trends: Medium risk.** We expect long-term growth for midstream energy assets because they serve the essential need of transporting hydrocarbons to their end markets. However, growth can fluctuate in the short term, sometimes materially, depending on the economic cycle and commodity prices. Many midstream energy companies' revenues are determined by throughput volumes, which are in turn determined by commodity prices. Producers' incentives are heavily influenced by commodity prices.

20. Prices for natural gas are affected by changes in industrial demand and production, residential heating needs, and power demand. NGL demand is highly correlated to industrial production and is driven largely by petrochemical and oil refining. Oil demand is ultimately affected by global economic growth and the rate of industrialization. When oil prices drop, there is less demand for a midstream energy company's assets, and profits can suffer. In North America, this happened last in late 2008 and early 2009, although the period of low demand was short.

**Country risk**

21. Country risk plays a critical role in determining all ratings on companies in a given country. Country-related risk factors can have a substantial effect on company creditworthiness, directly and indirectly. In assessing country risk for a midstream energy company, we use the same methodology that we use for other corporate issuers (see "Corporate Methodology"). A key factor in our business risk analysis for corporate issuers is the country risk assessment, which includes the broad range of economic, institutional, financial market, and legal risks that arise from doing business in a specific country.

22. We generally determine exposure to country risk by examining sources of revenue because this information is consistently available. However, this may not capture country risks beyond those affecting demand. Therefore, if data is available on EBITDA or assets and indicates a materially different country exposure profile from revenues, we may use EBITDA or assets to determine country risk. This could be the case, for instance, if a company's production is in countries with higher-risk profiles than where it derives its revenue from, especially if those assets cannot easily be moved.

**Competitive position (including profitability)**

23. Under our global corporate criteria, we assess a company's competitive position as "excellent," "strong," "satisfactory," "fair," "weak," or "vulnerable." In assessing the competitive position for midstream energy companies, we review the following components:

- Competitive advantage;
- Scale, scope, and diversity;
- Operating efficiency; and
- Profitability.

24. We assess each of the first three components as "strong," "strong/adequate," "adequate," "adequate/weak," or "weak." We assess profitability separately by analyzing two subcomponents: the level of profitability, and the volatility of profitability.
After evaluating the first three components, we determine the preliminary competitive position assessment by ascribing a specific weight to each component. The applicable weightings will depend on the company's Competitive Position Group Profile (CPGP).

The CPGP assigned to midstream energy companies we rate can be "National Industries and Utilities," "Commodity Focus/Scale Driven," or "Capital or Asset Focus." Competition and industry conditions could differ vastly within the midstream sector because of the broad range of segments and company profiles:

- For midstream energy companies that have low commodity exposure and have monopolistic characteristics, we typically assign the "National Industries and Utilities" CPGP. Such companies have low or no competition in their markets, regulatory protection, or other effective barriers to entry (for example, country-specific regulations like environmental or ownership requirements). Examples of such companies would be regulated interstate pipelines. The component weighting for these companies is as follows: competitive advantage (60%); scale, scope, and diversity (20%); and operating efficiency (20%).
- For midstream energy companies that operate in competitive markets where hydrocarbon prices can have a direct effect on profit margins or where there is significant risk of volume declines because of these prices, we typically assign the "Commodity Focus/Scale Driven" CPGP. An example would be natural gas processing companies with a significant portion of profits tied directly to NGL prices. The component weighting for these companies is as follows: competitive advantage (10%); scale, scope, and diversity (55%); and operating efficiency (35%).
- For midstream energy companies that have a balanced mix of operating segments in the sector, such as assets related to low-risk transportation and those with direct commodity-price exposure, we typically assign the "Capital or Asset Focus" CPGP. Examples would be integrated companies with a mix of assets in both highly competitive and less competitive markets, or in markets with little excess capacity in which a company's ability to commit capital to secure revenues from a new-build project or asset expansion is a key differentiator. The component weighting for these companies is as follows: competitive advantage (30%); scale, scope, and diversity (30%); and operating efficiency (40%).

Some diversified midstream energy companies have business lines that fall outside the midstream energy industry. Where applicable, we assess the competitive positions of those businesses independently by following the key credit factors relevant to those industries.

**Competitive advantage.** In assessing a midstream energy company's competitive advantage, we consider the following:

- The resiliency of volume flows;
- The contract profile;
- Commodity price exposure; and
- The regulatory framework under which the company operates.

In reviewing the resiliency of commodity-related production volume, we consider volume flow records through different commodity price and economic cycles. For instance, gathering lines located in a mature basin or in one with a relatively high cost structure could experience more volatility and annual double-digit production declines.

In reviewing the contract profile, we consider the length, type of customer (and creditworthiness), and potential for profit margin volatility. Contract terms such as minimum-volume guarantees can help ensure greater revenue stability. We may also evaluate the company's insurance coverage, especially for single-asset midstream companies that are
exposed to geopolitical and weather-related risks.

31. In reviewing commodity price exposure, we consider the percentage of EBITDA that is sensitive to commodity prices. An entity with a high percentage of EBITDA that is sensitive to commodity prices and that could have more volatile cash flows will have a less favorable assessment than a company with little EBITDA exposed to commodity prices and with stable cash flows.

32. In reviewing the regulatory framework, we consider the additional credit support that the regulation provides. For example, a pipeline in certain jurisdictions may be able to raise tariffs to offset high operating expenses and generate a stable return on capital (ROC). Regulatory systems differ across countries and may contribute to a positive assessment if we believe the regulations will insulate an entity's profits from high operating costs and competition, but we generally consider the effect to be minor.

33. A midstream energy company with a "strong" or "strong/adequate" competitive advantage assessment typically is characterized by a combination of the following factors:

- Strong predictability of volume deliveries through take-or-pay contracts, assets located in a low-cost basin with prospects for significant growth potential, a high cost of alternative transportation, or customers that are highly dependent on the services provided (e.g., demand-pull pipelines);
- A high degree of fee-based activities;
- Long-term contracts (8+ years of remaining life);
- Minimal commodity price exposure; or
- A regulatory environment that provides mechanisms to achieve stable rates of return.

34. A midstream energy company with a "weak" or "adequate/weak" competitive advantage assessment typically is characterized by a combination of the following factors:

- Little volume certainty because of a lack of contractual arrangements, poorly situated assets, low-cost alternative transportation, or significant risk from competitors;
- Few long-term contracts or a large number of non-investment-grade counterparties that represent more than 50% of cash flows;
- High commodity price exposure; or
- Minimal regulatory barriers to entry and a lack of credit support.

35. **Scale, scope, and diversity.** In assessing a midstream energy company's scale, scope, and diversity, we consider:

- Operating scale and geographic diversity;
- Diversity of commodity exposure;
- Integration with other complementary business lines; and
- Diversification of the customer base.

36. We generally consider large-scale companies to have stronger business risk profiles with more operating flexibility and economies of scale than small companies.

37. Geographic diversification provides protection against risk factors that may affect one region more than another, such as regional price fluctuations or a basin's geological quality. The nature of the other business lines and the correlation between them can add to or detract from our assessment. A company with an integration model that enhances the
scale and product offerings while allowing the company to maintain a mostly fee-based revenue model and acceptable ROC will have a favorable assessment. Conversely, a company with an integration model that increases the commodity price exposure without materially improving the scale and product offerings will have an unfavorable assessment.

38. A diverse customer base minimizes customer concentration, thereby reducing the potential for operational disruptions and cash flow volatility. Conversely, a heavily concentrated customer base could lead to material swings in cash flows and operational disruptions if issues arise with key counterparties.

39. A midstream energy company with a "strong" or "strong/adequate" scale, scope, and diversity assessment typically is characterized by a combination of:

- Large scale and scope of operations, with assets typically in three or more geographically diverse basins with robust drilling economics, or if assets in two, or even one, basin if the basin is very large and cost-competitive (e.g., the Canadian oil sands area);
- High market share in the company's operational areas;
- Diversification by commodity type; or
- Integration among a large number of parts of the midstream value chain, such as gathering and processing, transportation, and storage assets, which are connected even though they operate independently.

40. A midstream energy company with a "weak" or "adequate/weak" scale, scope, and diversity assessment typically is characterized by a combination of:

- Limited assets or scope of operations;
- Limited geographic diversity in one or two basins that are relatively small or not cost-competitive;
- High exposure to one commodity type; or
- Limited integration among business lines.

41. Operating efficiency. In assessing a midstream energy company's operating efficiency, we consider:

- The scalability of growth-oriented capital spending;
- The size of maintenance capital spending relative to the overall capital spending budget;
- The cost profile of operating assets; and
- The degree of asset utilization.

42. In reviewing the scalability of growth-oriented capital spending, we consider construction risk and the potential for cash flow lag (meaning the company immediately incurs debt to fund a project but does not receive cash flows until it completes the project). In assessing the potential for cost overruns, we analyze the project type, the level of risk the engineering and construction company assumes, mitigants in place (e.g., whether management has already purchased raw materials at a fixed price), and the company's experience with building similar projects.

43. In reviewing the size of maintenance capital spending relative to the overall capital spending budget, we focus on the company's track record of properly maintaining assets and ensuring good safety records, which are good leading indicators for operational risks. We also review the cost profile of operating assets; a high proportion of fixed costs could dampen cash flows when utilization declines, while low variable costs could boost profitability when utilization is high.
44. In reviewing the degree of asset utilization, we determine the competitive advantage of certain assets if we have sufficient data.

45. A midstream energy company with a "strong" or "strong/adequate" operating efficiency assessment typically is characterized by a combination of:

- Highly scalable growth capital and low maintenance capital spending per unit;
- Low-cost operations, such as operating and maintenance expenses as a percentage of revenues;
- A high proportion of variable versus fixed costs; or
- Asset utilization of about 80% or more on a normalized basis.

46. A midstream energy company with a "weak" or "adequate/weak" operating efficiency assessment typically is characterized by a combination of:

- Low scalability of growth capital and high maintenance capital required relative to the company's size or cash flow generation;
- High-cost operations/fixed costs; or
- Asset utilization of about 50% or less on a normalized basis, due for example to weak commodity prices or a deteriorating competitive advantage.

47. **Profitability.** The profitability assessment can confirm or modify the preliminary competitive position assessment. The profitability assessment consists of two components: the level of profitability, and the volatility of profitability. The two components are combined into the final profitability assessment using a matrix (see "Corporate Methodology").

48. **(A) Level of profitability.** We assess the level of profitability on a three-point scale: "above average," "average," and "below average." We use ROC as the primary indicator of a midstream energy company's profitability, based on certain thresholds (see table 1).

<table>
<thead>
<tr>
<th>Midstream Energy Company Return On Capital Percentage Thresholds</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Below average</strong></td>
</tr>
<tr>
<td>Low-risk midstream companies</td>
</tr>
<tr>
<td>All other companies</td>
</tr>
</tbody>
</table>

49. We use EBITDA margin as a supplementary indicator to refine our assessment when ROC is close to the thresholds for "below average" or "above average" (see table 2).

<table>
<thead>
<tr>
<th>Midstream Energy Company EBITDA Margin Percentage Thresholds</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Below average</strong></td>
</tr>
<tr>
<td>All companies</td>
</tr>
</tbody>
</table>

50. EBITDA margin may not be appropriate for certain companies, such as pipelines that do not take title to the product or that pass through costs to their customers. For this assessment, we typically calculate the five-year average ROC and EBITDA margin using the past two years of historical data and three years of forecast data, in accordance with our global corporate criteria. We may put more emphasis on forecast years if historical data is not representative, or to take into account deteriorating or improving risk profiles if prospective ratios differ meaningfully from average ratios.
In some cases, we may use different thresholds for companies that report under local accounting rules rather than U.S. GAAP or IFRS standards.

51. When analyzing ROC and EBITDA margins, we recognize that the measures can vary materially among industry segments. For instance, regulated pipelines generally have low ROCs, while those with commodity exposure generally have high ROCs. In assessing ROCs for midstream energy companies that have most of their assets on the low end of the risk spectrum (such as regulated long-haul pipelines), we use the "low-risk midstream companies" category. For the remainder, we use the "all other companies" category.

52. (B) Volatility of profitability. We determine volatility of profitability on a six-point scale, from '1' (least volatile) to '6' (most volatile). In accordance with our global corporate criteria, we generally use the standard error of regression (SER), subject to having at least seven years of historical annual data, and we generally use nominal EBITDA to determine the SER for midstream energy companies, although we may also use EBITDA margin or ROC in addition to nominal EBITDA. We also may adjust the SER assessment by up to two categories worse (more volatile) or better (less volatile), subject to certain conditions. If we do not have sufficient historical information to determine the SER, we follow our global corporate criteria guidelines to determine the volatility of profitability.

**Part II—Financial Risk Analysis**

**Accounting and analytical adjustments**

53. In assessing the accounting characteristics of midstream energy companies, we use the same methodology that we use for other corporate issuers (see "Corporate Methodology"). Our analysis of a company's financial statements begins with determining whether the statements accurately measure the company's performance and position relative to those of its peers and the universe of corporate entities. To allow for globally consistent and comparable financial analyses, we may include quantitative adjustments to a company's reported results. These adjustments also enable better alignment of a company's reported figures with our view of underlying economic conditions and allow for a more accurate portrayal of a company's ongoing business. Adjustments that pertain broadly to all corporate sectors, including this sector, are discussed in "Corporate Methodology: Ratios And Adjustments," published Nov. 19, 2013. The most relevant adjustments we make for midstream energy companies relate to joint ventures and financial derivatives.

**Cash flow/leverage analysis**

54. In assessing a midstream energy company's cash flow adequacy, we use the same methodology that we use for other corporate issuers (see "Corporate Methodology"). We assess cash flow/leverage on a six-point scale, ranging from '1' (minimal) to '6' (highly leveraged), by aggregating the assessments of a range of credit ratios, predominantly cash flow-based, that complement each other by focusing attention on the different levels of a company's cash flow waterfall in relation to its obligations.

55. In accordance with our global corporate criteria, we typically place the greatest weight on data for forecasted years rather than historical years because we believe the former are more representative of a company's long-term cash-generating ability. This will allow us to better analyze the effects of temporary capital spending or transformative acquisitions. Current and historical ratios can often be skewed during large, ongoing capital projects if a company has not yet realized associated cash flows. In such cases, we would focus primarily on forecasted ratios.
Core ratios

56. For each company, we calculate two core debt-payback ratios, funds from operations (FFO) to debt and debt to EBITDA, in accordance with our ratios and adjustment criteria (see "Corporate Methodology: Ratios And Adjustments").

Supplemental ratios

57. We also consider supplemental ratios to develop a fuller understanding of a company's credit risk profile and to refine our cash flow analysis, in accordance with our global corporate criteria. For midstream energy companies, free operating cash flow (FOCF) to debt is the preferred supplemental ratio, as it could confirm or adjust the core financial ratios. In calculating FOCF, we often use only maintenance-related capital spending, as discretionary growth spending can be high and would skew the ratio expectations in a more normalized growth environment.

58. When the cash flow/leverage assessment indicated by the core ratios is "significant" or weaker, we may instead use debt service coverage ratios (FFO plus interest/cash interest, or EBITDA/interest).

Volatility tables

59. The midstream energy industry encompasses a large variety of companies, from highly stable long-haul pipelines to companies with material, direct commodity price exposure. Depending on the company's business risk profile, we will apply the "low," "medial," or "standard" volatility table.

60. We apply the "low volatility" table to midstream energy companies with a Corporate Industry and Country Risk Assessment (CICRA) of '2' and that meet the following conditions:

- A competitive position assessment of at least '3' ("satisfactory"); and
- At least 90% of forecasted operating cash flow is related to firm, long-term contracted revenue streams or fee-based activities with very low volume risk. To the extent that the company is engaged in other industries, its midstream operations must meet the previous condition, and its other cash flows must come from highly stable business lines (e.g., regulated utilities or merchant power with long-term power purchase agreements).

61. We apply the "medial volatility" table to midstream energy companies that meet the following characteristics:

- The CICRA is generally '2' but in certain circumstances may be '3', provided the company meets the third condition below;
- A competitive position assessment of at least '4' ("fair"); and
- At least two-thirds of forecasted operating cash flow is related to firm contracted revenue streams or fee-based activities with very low volume risk. To the extent that the company is engaged in other industries and has an overall CICRA of '3', its midstream operations must meet the previous condition, and its other cash flows must come from highly stable business lines (e.g., regulated utilities or merchant power with long-term power purchase agreements).

62. In all other cases, we use the "standard volatility" table.

Part III--Rating Modifiers
Diversification/Portfolio effect
63. In assessing a midstream energy company's diversification/portfolio effect, we use the same methodology that we use for other corporate issuers (see "Corporate Methodology"), i.e., reserving potential diversification benefits to companies whose portfolios span different industries, as defined by our industry classification.

Capital structure
64. In assessing the quality of a midstream energy company's capital structure, we use the same methodology that we use for other corporate issuers (see "Corporate Methodology").

Liquidity
65. In assessing a midstream energy company's liquidity, we use the same methodology that we use for other corporate issuers (see "Corporate Methodology").

66. In the more stable subsectors of midstream energy, such as interstate pipelines or highly contracted storage assets, we allow for more lenient ratios relative to the general guidelines. Specifically, to meet our definition of adequate liquidity, we consider a sources-to-uses ratio of 1.1x, instead of the standard 1.2x. We also consider covenant cushions of 10% instead of the standard 15%. For subsectors with more meaningful volume and price risks, such as the larger diversified midstream energy companies or the gathering, processing, and fractionation sector, we use the benchmarks outlined in our general liquidity criteria (see "Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers," published Nov. 19, 2013).

Financial policy
67. In assessing a midstream energy company's financial policy, we use the same methodology that we use for other corporate issuers (see "Corporate Methodology").

Management and governance
68. In assessing a midstream energy company's management and governance, we use the same methodology that we use for other corporate issuers (see "Corporate Methodology").

Comparable ratings analysis
69. In assessing a midstream energy company's comparable ratings analysis, we use the same methodology that we use for other corporate issuers (see "Corporate Methodology").

Other Considerations
70. Despite the aforementioned factors, ratings on material counterparties may cap a midstream company's stand-alone credit profile (SACP). If a counterparty's contracts represent the vast majority of a midstream company's revenue streams, and we believe the company likely would not be able to replace the contracts at current rates, the counterparty ratings would constrain the midstream company's SACP.

71. As an example, if a midstream company's business risk and financial risk profiles are "strong" and "intermediate," respectively, the midstream company's anchor assessment would be 'a-' or 'bbb+' according to table 3 in our global corporate criteria. Assuming the anchor assessment is 'a-' and all modifiers are neutral, the company's SACP prior to considering the counterparty exposure would also be 'a-'. However, if (i) contracts represent a key business risk, (ii) the
counterparty issuer credit rating is 'BBB-', and (iii) we believe the midstream company would not be able to replace the contracts at current rates, we would cap the midstream company's SACP at 'bbb-'.

72. If we lower the counterparty ratings, we may or may not also lower the SACP on the midstream company, depending on the circumstances. For example, if the midstream energy company's principal asset is a bespoke pipeline with no other uses than supplying crude oil to Company X's refiner, and Company X's corporate credit rating is 'B', we would likely lower the midstream company's SACP to 'b'.

73. On the other hand, if the midstream energy company's assets had several other potential customers, we would not equalize the ratings. We may conclude that the company would likely be able to sign up other customers quickly and at similar rates, and had sufficient liquidity to persevere if the counterparty defaulted. In the example from paragraph 71, we may conclude that—barring any existing contracts—the midstream company's business and financial risk profiles would be "satisfactory" and "aggressive," respectively, leading to an anchor assessment of 'bb'. Therefore, excluding the potential effect of any further rating modifiers, the midstream energy company's SACP would not fall below 'bb' even if we lowered the counterparty issuer credit rating below 'BB'.

RELATED CRITERIA AND RESEARCH

- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Principles of Credit Ratings, Feb. 16, 2011