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### CREDIT OPINION

11 August 2016

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#### RATINGS

##### Public Service Company of Colorado

Domicile	Denver, Colorado, United States
Long Term Rating	A3
Type	LT Issuer Rating
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Public Service Company of Colorado

Vertically Integrated Electric and Gas Utility subsidiary of Xcel

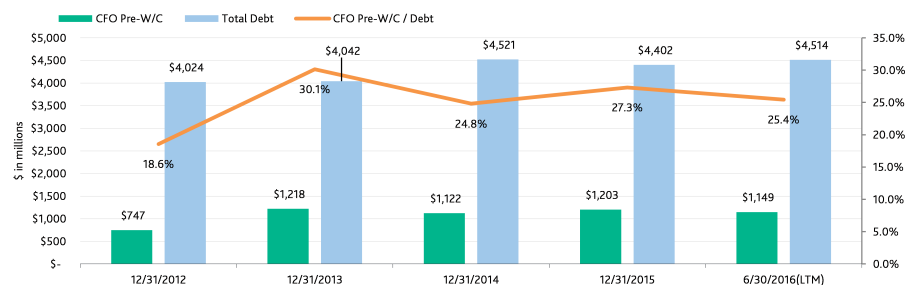
### Summary Rating Rationale

The A3 senior unsecured rating of Public Service Company of Colorado (PSCo) captures the vertically integrated electric and natural gas distribution utility's constructive relationship with the Colorado Public Utility Commission (CPUC). It also reflects an overall credit supportive regulatory environment in terms of balanced rate case outcomes and a shift towards riders and forward-looking recovery mechanisms, a credit positive for PSCo's cash flows.

The utility's material, multi-year capital investment program has expanded its rate base significantly to almost \$9 billion such that it currently ranks as parent company Xcel Energy Inc's (A3 stable) largest subsidiary in terms of contribution (40%-50%) to the consolidated net income. The rating is further underpinned by our expectation that credit metrics will remain commensurate with the A-rating category despite the increased leverage to finance elevated capital investments. This expectation factors in the utility's robust regulatory equity layer, tax savings benefits following the extension of bonus depreciation, along with group-wide cost saving initiatives.

Exhibit 1

#### Historical CFO Pre W/C, Total Debt and CFO Pre W/C to Debt



Source: Moody's Financial Metrics

### Credit Strengths

- » Credit constructive regulatory environment that is shifting towards the implementation of riders
- » Credit metrics that are expected to remain commensurate with the A-rating category

## Credit Challenges

- » 2016-2020 capital investments will remain elevated and could expose the utility's cash flows to some regulatory lag in the absence of new riders

## Rating Outlook

The stable outlook assumes that PSCo's regulatory environment will remain credit supportive and that Xcel will contribute sufficient capital as needed to maintain the utility's capital structure. A change in Xcel's rating or outlook could cause a similar change at PSCo.

## Factors that Could Lead to an Upgrade

PSCo's ratings could experience positive momentum if there is an improvement in the regulatory environment including credit supportive rate cases outcomes that help PSCo exhibit credit metrics that are robust for the A-rating category, for example, CFO Pre-WC/Debt and Retained Cash Flow/Debt in excess of 25% and 20%, respectively, on a sustainable basis.

## Factors that Could Lead to a Downgrade

The ratings could be downgraded if there is a deterioration in the credit supportiveness of the regulatory environment, including adverse regulatory rulings and/or a more aggressive financing strategy. The rating could also be downgraded if there is a decline in the utility's financial metrics to levels that are not commensurate with the low-end of the A-rating category; specifically if CFO pre-WC / Debt falls below 20% for an extended period.

## Key Indicators

Exhibit 2

### KEY INDICATORS [1]

Public Service Company of Colorado

	12/31/2012	12/31/2013	12/31/2014	12/31/2015	6/30/2016(L)
CFO pre-WC + Interest / Interest	5.0x	7.7x	7.3x	7.7x	7.2x
CFO pre-WC / Debt	18.6%	30.1%	24.8%	27.3%	25.4%
CFO pre-WC – Dividends / Debt	11.9%	23.6%	15.2%	19.8%	18.0%
Debt / Capitalization	38.7%	36.6%	38.2%	36.0%	36.0%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

Source: Moody's Financial Metrics

## Detailed Rating Considerations

### BALANCED RATE CASE OUTCOMES AND SHIFT TOWARD RIDERS ENHANCES REGULATORY SUPPORT

Our opinion about the credit supportiveness of the regulatory environment under which PSCo operates considers the overall balanced outcomes of the utility's last two rate cases (electricity and natural gas). Importantly, it also considers the Colorado regulator's shift towards automatic rate adjustment mechanisms such as forward-looking riders. They enhance the utility's cash flow visibility and reduce regulatory lag as rates are based on historical test years and given the utility's material capital expenditures.

PSCo's electric operations (around 80% of its rate base) are subject to a three-year rate plan that will expire next year. The net rate increase of \$53 million approved in February 2015 equaled around 50% of the requested amount, while the multi-year plan reduced uncertainty and some costs related to serial rate cases. The rates were based on 2013 test year but the electric operations benefit from four riders that allow for recovery between rate cases of forward-looking costs associated with transmission investments and capital outlays under the Clean Air Clean Jobs Act (CACJA) as well as with pensions and property taxes. The rates are premised on a robust 56% equity layer but the authorized 9.8% Return on Equity (RoE) is somewhat low compared to its US peers. In July 2016, the CPUC ordered the refund of \$14.9 million under PSCo's 2015-2017 earning test after the utility recorded a 9.96% actual RoE last year.

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In July 2016, the utility filed for CPUC approval of a partial electric decoupling mechanism for a five year period, effective in 2017. The mechanism seeks annual adjustments of the utility's revenues based on changes in average use per customer on a weather normalized basis for the residential as well as the small customer and industrial (C&I) classes. Its approval would help enhance the visibility of the utility's cash flows because it would eliminate the impact of demand side management, distributed generation and other energy saving programs on sales, a credit positive. However, cash flow would be still exposed to weather related fluctuations, a credit negative.

On a weather adjusted basis, sales to electric residential customers increased during the 1H2016 by 1.9% compared to the 1H2015 (year-end 2015: +0.4%; 2014: +0.3%), while on an actual basis they grew by 3.3% (2015: +1.1%; 2014: -2.8%). The utility's customer base continues to grow but usage per customer is declining. In contrast, sales to C&I continue to decline both on a weather adjusted and actual basis (during the 1H2016 actual: -1.1% versus 1H2015; 2015:-0.9%; 2014:+0.3%) due to a drop in the demand from large manufacturing that supports mining and the oil & gas industries.

In contrast to the electric operations, in February 2016, the CPUC did not authorize the implementation of PSCo's requested 3-year natural gas rate plan which sought an aggregated rate increase of \$109.2 million. On a positive note, the CPUC approved rate increase for the first year approximated 96% of the \$40.4 million request; however, this increase included \$20.5 million which was largely related to the transfer of the operation and maintenance costs under the Pipeline Integrity Rider Adjustments (PSIA) to base rates. This portion of the rate increase became effective in January 2016 while the balance of \$18.7 million was applied retroactively to October 2015, that is when interim rates became effective.

The PSIA-rider was extended through 2018 (requested: through 2020) and allows for the recovery of costs associated with transmission and distribution pipeline integrity management programs as well as with two projects to replace large transmission pipelines, a credit positive. The PSIA-rider helps reduce regulatory lag concerns because PSCo's natural gas rates are based on the 13-month average historical test year 2014 rate base. However, it also includes investments related to the pipeline to supply the 576MW Cherokee combined cycle plant (completed in 2015). The natural gas rates are also premised on a robust 56.5% equity layer; however the authorized RoE of 9.5% was below the sought 10.1% RoE as well as below the average for natural gas distribution companies in the US. Most of these companies also benefit from decoupling mechanisms which is not the case for PSCo.

### **CAPITAL EXPENDITURES REMAIN ELEVATED**

Environmental spending to comply with Colorado's 2010 CACJA has dominated the company's regulatory and financing efforts. Between 2011-2017, PSCo will invest around \$1 billion in order to meet the state's nitrogen oxides emission reduction requirements from identified coal-fired plants by the end of 2017 (by 70%-80% from 2008 levels). The initiatives included: the installation of emission control equipment at the Hayden and Pawnee coal-fired facilities (PSCo's total ownership: 742MW) and the commission last year of the 3-unit Cherokee CCGT plant (around \$530 million) mentioned earlier. This plant replaced three coal-fired units at the previous Cherokee plant while the fourth 352MW unit will be converted to natural gas (2017). PSCo is currently recovering the investments via the CAJCA-Rider which during 2015 increased the utility's margins by \$94 million, a credit positive. PSCo has continued retiring less efficient coal-fired facilities including the 352MW Cherokee Unit 3 (August 2015) and the 184MW Valmont Unit 5 (anticipated before year-end 2017). It expects that these initiatives will allow the utility to meet all current environmental mandates.

Nevertheless, according to Xcel's last updated capital plans, PSCo's 2016-2020 investments will remain elevated with total planned capital outlays on identified projects of around \$5 billion (2011-2015: almost \$4.7 billion). The investments are largely related to the continuation of the utility's integrity management programs to ensure the reliability of gas transmission and to replace aging electric distribution infrastructure (around \$150 million p.a.) which are largely recovered through the PSIA-rider. In June 2016, the utility withdrew its application for natural gas reserves investment due to the litigious approval process (capex: \$500 million over 10 years) but in August 2016 filed for a certificate of public convenience for advanced grid initiatives (2016-2020: \$500 million).

In May 2016, the utility also filed its 2017 Electric Resource Plan which identified total needs for 615MW of additional capacity by 2023. Under the base case of the Plan-Phase I (expected completion: 2Q of 2017), PSCo considered various resources including a 410MW CCGT, a 700MW of combustion turbine and 600MW of customer sited solar generation. In May 2016, it also proposed the construction of the 600MW Rush Creek Wind project (capex around \$1 billion) or 400MW other renewable related projects. These incremental investments are currently excluded from Xcel's and PSCo's base case investments mentioned above. PSCo anticipates that if approved by the CPUC (decision expected before year-end) this wind project could come online in December 2018. The pre-

approvals of these investments reduce the likelihood of disallowances; however, in the absence of new riders for the recovery of these investments, the utility's cash flows could be also exposed to regulatory lag until the next rate cases.

As of year-end 2015, PSCo met around 66% of its power requirements with its fleet's output. Efficient coal-fired facilities accounted for around 54% of the output last year, followed by the power generated by the natural gas facilities (23%) while the balance was sourced from renewables (including wind and hydro: 2%). However, we anticipate some changes in this energy mix this year, considering the full-year of operations of PSCo's Cherokee CCGT as well as the new PPAs that became effective after the completion of a 450MW wind farm and 170MW solar plants (2015:50MW).

### BONUS DEPRECIATION LIFTS CASH FLOW METRICS

As depicted in the grid above, the utility exhibits key credit metrics that remain well positioned within the A-range on the standard grid under our Regulated Electric and Gas Utilities rating methodology. In 2015, PSCo's financial performance benefited from the implementation of the aforementioned riders (e.g. margin increase from the CAJCA-rider: \$94 million) along with some debt reduction (2015: \$126 million) and moderate dividends, while the utility further benefited from tax savings associated with bonus depreciation.

We anticipate that the utility will be able to continue to generate credit metrics that are commensurate with the A-rating category following the extension of bonus depreciation, group-wide cost saving initiatives and the continuation of its capital investment program that is further funded to allow the utility to record its robust regulatory equity layer.

### Liquidity Analysis

PSCo's short-term Prime-2 rating reflects an adequate liquidity profile. PSCo's \$700 million CP program is back-stopped by a same-sized committed revolving credit facilities. Similar to Xcel and its sister companies, in June 2016, PSCo entered into an amended credit agreement that extended its maturity to June 2021.

At the end of June 2016, the utility had \$4.3 million of cash on hand and \$697 million available under this credit facility (letter of credits outstanding: \$3 million).

The facilities provide for same day funding and borrowings are not subject to conditionality. The facility contains one financial covenant, namely a total Debt / Capitalization ratio below 65% (June 30, 2016 and 2015: 45%; 2014: 47%). We anticipate the utility will be able to continue to comfortably comply with this covenant. In addition to its own credit facility, PSCo also participates in a regulated money pool with its sister companies Northern States Power-Minnesota and Southwestern Public Service. As of 30 June 2016, PSCo had \$40 million of borrowings under its \$250 million limit under the money pool (2015: \$0). The money pool allows for short-term loans among those utility subsidiaries, and allows for short-term loans from Xcel to the utilities. However, it does not allow loans from the utilities to Xcel.

The proceeds of \$250 million of first mortgage bonds issued in June 2016 were largely used to repay short-term debt and fund capital expenditures. The utilities' next debt maturity will be due in August 2018 for the amount \$300 million after PSCo called in June the \$129.5 Notes that were due in September 2017. For the rest of 2016, we anticipate that PSCo will fund its capital requirements, including investments (total in 2016: \$975 million) largely with internally generated cash flows (2015: \$1.2 billion) and short-term borrowings until refinanced with long-term. We anticipate that Xcel will further manage PSCo's dividend policy (LTM June 2016: \$334 million) and equity contributions to the utility (LTM June 2016: \$116 million) so as to maintain its regulatory capital structure.

### Corporate Profile

Public Service Company of Colorado (PSCo, A3 senior unsecured) is the largest integrated utility in Colorado, where it serves 1.4 million electric customers (rate base: \$6.5 billion) and 1.4 million natural gas customers (rate base: \$1.8 billion). The utility also renders sales for resales and wholesale transmission service (rate base: \$620 million). PSCo's parent, Xcel Energy Inc. (Xcel, A3 senior unsecured), is a holding company with utility operations in eight states serving 5.5 million natural gas and electric customers. In terms of earnings PSCo is the largest of Xcel's four utility subsidiaries but it ranks as the second largest in terms of rate base.



## Ratings

Exhibit 4

Category	Moody's Rating
<b>PUBLIC SERVICE COMPANY OF COLORADO</b>	
Outlook	Stable
Issuer Rating	A3
Senior Secured MTN	(P)A1
Sr Unsec Bank Credit Facility	A3
Senior Unsecured Shelf	(P)A3
Commercial Paper	P-2
<b>PARENT: XCEL ENERGY INC.</b>	
Outlook	Stable
Issuer Rating	A3
Sr Unsec Bank Credit Facility	A3
Senior Unsecured	A3
Subordinate Shelf	(P)Baa1
Jr Subordinate Shelf	(P)Baa1
Pref. Shelf	(P)Baa2
Commercial Paper	P-2

Source: Moody's Investors Service

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