FitchRatings

Fitch Affirms MidAmerican Energy Holdings Co. & Subsidiaries; Outlook Stable

Ratings
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Fitch Ratings-New York-01 October 2010: Fitch Ratings has affirmed the MidAmerican Energy Holdings Company's (MEHC) long- and short-term Issuer Default Ratings (IDR) at 'BBB+' and 'F2', respectively. Fitch has also affirmed MEHC's individual security ratings and its subsidiary IDR and instrument ratings as listed below. The Rating Outlook is Stable. Approximately $20 billion of debt is affected by the rating action.

Key MEHC rating drivers include:
--The underlying financial strength and relative predictability of its core U.S.-based electric utility and natural gas pipeline companies and U.K. electric distribution utilities;
--The salutary financial affects of MEHC's affiliation with Berkshire Hathaway Inc. (BRK; IDR 'AA-' with a Stable Outlook);
--Regulatory outcomes in pending and future rate case proceedings;
--Execution of MEHC's capital expenditure program.

MEHC's ratings and Stable Outlook reflect the company's diversified cash flows from six relatively low-risk utilities and natural gas pipelines located in the U.S. and U.K., solid and improving credit metrics, strong liquidity position and manageable planned 2010-2014 capital expenditures. MEHC's ratings also consider the positive credit implications of its status as a subsidiary of BRK, including BRK's strategic commitment to expand MEHC's investments in regulated assets. BRK has opportunistically provided capital and financing to MEHC to pursue such acquisitions, including the March 2006 PacifiCorp (PPW) acquisition; aborted acquisition of Constellation Energy Group (CEG) in 2008; and, an investment in BYD Company Limited (BYD) in 2009.

MEHC's affiliation with BRK provides two unique, specific financial advantages to the intermediate holding company and its subsidiaries. These two factors mitigate concern regarding MEHC's moderately high consolidated financial leverage relative to Fitch's 'BBB+' guidelines and large consolidated capital expenditure program.

First, unlike most utility holding companies, MEHC benefits significantly from capital retained as the direct result of BRK's financial strength, which obviates the need to upstream dividends. Second, MEHC and BRK recently extended the equity commitment agreement (ECA) originally put in place in March 2006. The ECA provides equity capital of up to $3.5 billion at the request of MEHC. ECA equity contributions may only be used for the purpose of paying MEHC debt obligations when due and funding the general corporate purposes and capital requirements of MEHC's regulated subsidiaries. The ECA was set to expire Feb. 28, 2011. Earlier this year, the ECA was extended through February 2014 and the commitment level lowered from $3.5 billion to $2 billion effective March 1, 2011. The reduction reflects reduced equity capital requirements at PPW and lower anticipated MEHC parent level debt maturities.

In addition, MEHC benefits from its affiliation with BRK through opportunistic M&A activity, which is funded separate from the ECA. For example, MEHC received after-tax cash proceeds of $1.7 billion in 2008 and 2009 following termination of its planned acquisition of CEG. After repaying $1 billion of preferred securities issued to its parent to fund the CEG transaction, cash proceeds to MEHC were approximately $725 million, of which $493 million was used to reduce debt and fund capital expenditures. MEHC invested the remaining $232 million in return for a 10% ownership interest in BYD, which is active in rechargeable battery, cell phone and other technology business lines and automobile manufacturing in China. MEHC's investment in BYD was valued at $1.3 billion as of Aug. 31, 2010. Fitch does not expect further investment in industries outside the core regulated utility and pipeline sector.

MEHC's operations include two domestic utilities, two domestic natural gas pipelines, and two electric distribution companies in the UK which together, accounted for 89% of 2009 MEHC revenue and 95% of consolidated operating income (before corporate and other expense).

MEHC's operating utility and natural gas subsidiaries benefit from solid stand-alone credit profiles, relatively stable earnings and cash flow characteristics and generally reasonable regulatory jurisdictions. The ratings assume that future regulatory rulings will continue to support reasonable earned returns and credit metrics consistent with Fitch's projections. Timely recovery of PPW's large capital expenditure program is crucial to the future creditworthiness of PPW and MEHC, in Fitch's view. Fitch notes that regulatory decisions since MEHC has owned PPW have been generally reasonable and balanced.

The ratings consider the improving trend evident in MEHC's credit metrics in recent years and assume the trend will continue through 2014. Fitch calculates earnings before interest, taxes, depreciation and amortization (EBITDA)-to-interest expense and funds-from-operations (FFO)-to-interest expense ratios of 3.1 times (x) and 3.5x, respectively, at June 30, 2010 and estimates that these credit ratios will strengthen to approximately 4x in 2014. Fitch expects MEHC's projected debt-to-FFO ratio to improve from 7x in 2010 to better than 6x in 2014. In Fitch's view, these credit metrics combined with the salutary effect of its status as subsidiary of BRK supports MEHC's current ratings and Stable Outlook.

MEHC's liquidity position was strong as of June 30, 2010, with $471 million of cash and cash equivalents on its consolidated balance sheet and $2.2 billion of available borrowing capacity under its $3 billion of consolidated revolving credit agreements. In addition, the company's ECA with BRK, as described above, provides up to $3.5 billion of equity capital through Feb. 28, 2011 and $2 billion through February 2014. During 2010-2014, $4.3 billion (22%) of MEHC's $19.7 billion of outstanding long-term debt is scheduled to mature.

Fitch's affirmation of PPW's 'BBB' IDR considers the company's solid financial position, competitive resource base, and relatively balanced, diversified regulatory environment. The current ratings and Stable Outlook assume PPW continues to benefit from parent company support and reasonable outcomes in pending and future rate proceedings to recover anticipated, significant capital investment. Rating concerns for PPW investors include execution and recovery of its large, planned capital investment. Emergence of more stringent environmental rules and regulations are also a concern.

The affirmation of MidAmerican Energy Co. (MEC) 'A-' and MidAmerican Funding, LLC's (MF) 'BBB+' IDRs reflect MEC's low business risk profile, strong credit metrics, low debt leverage and a relatively supportive regulatory environment in Iowa, which is MEC's largest jurisdiction. MEC benefits from a solid competitive position, and stable operating performance. Commodity exposure at MEC is mitigated by the utility's long capacity position.

MF is an intermediate holding company that is a wholly owned subsidiary of MEHC and the indirect parent of MEC. MF's ratings are based on the credit quality of MEC, which is the primary source of cash flow to service its debt obligations and also benefits from the support of its ultimate corporate parent, BRK.

The ratings affirmation for Northern Natural Gas Company (NNG) reflects the pipeline's strong standalone credit profile, solid credit protection measures, favorable operating characteristics and low regulatory risk. NNG's competitive position is strong with access to five major supply basins and a customer base primarily comprised of local distribution companies. Competitive pressures are mitigated by the pipeline's stable customer base and geographic location, in Fitch's opinion.

The ratings affirmation for Kern River Funding Corporation (KRFC) reflects the pipelines' relatively predictable earnings and cash flow metrics, reasonable regulatory oversight and manageable capital expenditure plans. KRFC is a financing vehicle for the long-term debt obligations of Kern River Gas Transmission Co. (KRGT). KRFC's debt is unconditionally guaranteed by KRGT, which owns and operates a 1,680 mile interstate pipeline delivering primarily Rocky Mountain Gas from Wyoming to markets in California, Utah, and Nevada. KRFC's 'A-' rating reflects KRFC/KRGT's standalone credit quality as the result of specific legal and structural separations from its parent, MEHC. KRFC/KRGT's credit quality benefits from a portfolio of binding long-term transportation contracts, a competitive market position, access to relatively low cost natural gas supply and a solid operating track record.

Fitch has affirmed the following ratings:

MidAmerican Energy Holdings Company (MEHC)
--Issuer Default Rating (IDR) at 'BBB+';
--Senior Unsecured Debt at 'BBB+';
--Trust Preferred Stock at 'BBB-';
--Short-term IDR at 'F2'.

PacifiCorp (PPW)
--IDR at 'BBB';
--Senior Secured Debt at 'A-';
--Senior Unsecured Debt at 'BBB+';
--Preferred Stock at 'BBB-';
--Short-term IDR at 'F2';
--Commercial Paper at 'F2'.

MidAmerican Funding, LLC (MF)
--IDR at 'BBB+';
--Senior Secured Debt at 'A-'.

MidAmerican Energy Company (MEC)
--IDR at 'A-';
--Senior Unsecured Debt at 'A';
--Preferred Stock at 'BBB+';
--Short-term IDR at 'F1';
--Commercial Paper at 'F1'.

Northern Natural Gas Company (NNG)
--IDR at 'A';
--Senior Unsecured Debt at 'A'.

Kern River Funding Corporation (KRFC)
--IDR at 'A-';
--Senior Unsecured Debt at 'A-'.

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Applicable Criteria and Related Research:
--'Utilities Sector Notching and Recovery Ratings' (March 16, 2010);
--'Corporate Rating Methodology' (Aug. 16, 2010);
--'U.S. Power and Gas Comparative Operating Risk (COR) Evaluation and Financial Guidelines'(Aug. 22, 2007);
--'Recovery Ratings and Notching Criteria for Nonfinancial Corporate Issuers' (Nov. 24, 2009);
--'Issuer Default Ratings and Recovery Ratings in the Power and Gas Sector' (Nov. 7, 2005);
--'Credit Rating Guidelines for Regulated Utility Companies' (July 31, 2007); and,
--'Equity Credit for Hybrids & Other Capital Securities' (Dec. 29, 2009).

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