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Summary:

Big Rivers Electric Corp., Kentucky; Rural Electric Coop

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Credit Profile		
Big Rivers Electric Corp. ICR		
Long Term Rating	BB-/Stable	Affirmed
Ohio Cnty, Kentucky		
Big Rivers Electric Corp., Kentucky		
Ohio Cnty (Big Rivers Electric Corp.) poll ctrl rfdg rev bnds (Big Rivers Elec Corp Proj) ser 2010A		
Long Term Rating	BB-/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has revised its outlook to stable from negative on the following:

- Its 'BB-' issuer credit rating on Big Rivers Electric Corp., Ky. (BREC); and
- Its 'BB-' rating on Ohio County, Ky.'s $83.3 million pollution control refunding revenue bonds, series 2010A (Big Rivers Electric Corp. Project) issued for Big Rivers' benefit.

At the same time, Standard & Poor's affirmed the 'BB-' ratings.

The outlook revision reflects our view of sound debt service coverage (DSC) of 1.4x in 2013 and preliminary results for 2014 that indicate DSC will be about 1.5x. We calculated 2013's DSC ratio after removing the $58.8 bullet maturity of its 1983 pollution control bonds (PCB) from scheduled principal payments because BREC retired the PCB maturity with proceeds of a 2012 loan. Net of the refinancing, BREC repaid $21.1 million of principal in 2013. Revenues available for debt would have produced DSC of only 0.75x of the year's scheduled maturities and interest payments if BREC had not refinanced the PCB maturity.

The strength of 2013's adjusted DSC and 2014's projected DSC ratios transcend the loss of its three members' two largest retail customers in August 2013 and January 2014. Those customers operate smelters that provided about 64% of 2012's operating revenues before moving their electricity purchases to the wholesale market.

Notwithstanding the presence of sound DSC, we have not raised the rating above 'BB-' because the utility increasingly relies on market sales of electricity for margins to compensate for lost loads. We consider the sustainability of market sales to be unpredictable. In our view, sales in competitive wholesale markets expose the utility to substantial price and volume uncertainty, which we consider to be inconsistent with stronger credit quality. Moreover, the strong demand for electricity that the Polar Vortex created likely enhanced 2014's financial performance, which also raises questions about the sustainability of that year's projected results. In addition, BREC faces sharply increasing principal amortization that could pressure revenue requirements for the utility to achieve sound DSC.

We also evaluate the utility's financial metrics against the backdrop of these factors:

- We believe that the departures of its two largest loads and their high load factors deprive the utility of the substantial anchors that historically supported much of its fixed costs and benefitted other customers' rates.
- In October 2013 and April 2014, the Kentucky Public Service Commission (KPSC) approved rate increases that we view as helping insulate credit quality from further declines and mitigating the financial impacts of the customer losses.
- The utility projects that the KPSC rate adjustments, in and of themselves, cannot sustain DSC at levels comparable to 2013's DSC and that it will need margins from sales of surplus power in competitive markets and load growth to replace some of the margins associated with the smelters. Nevertheless, BREC projects that the rate increases should provide margins that, with limited market sales, will meet debt service obligations. The financial forecast assumes that competitive market sales will provide about 40% of 2015's operating revenues and lesser amounts in subsequent years as the utility experiences projected load growth and pursues contracts for sales of its surplus power.
- Nonmember sales represented about 60% of 2014's megawatt-hour sales and more than 40% of operating revenues. However, nonmember sales' margins represented a lesser one-quarter of total margins.
- BREC's financial forecast stress case shows that declines in market sales relative to its base case assumptions can whittle DSC and necessitate higher member rates.
- About 35% of the utility's debt portfolio does not amortize before maturity, which boosts coverage relative to cooperative utilities with amortizing debt because the absence of amortization defers principal payments and reduces the DSC calculation's denominator.
- Although principal repayments in 2015-2019 will average $23.7 million, they will spike to $71 million in 2020 and $67 million in 2021. BREC projects that its cash flows will be sufficient to retire these maturities.
- The utility's debt service is back-loaded, which could stress revenue requirements. Compared with the cited 2015-2019 average principal payments, BREC's principal payments will increase sharply even after repaying bullet maturities in 2020 and 2021. It forecasts that 2022-2023 principal payments will average $34 million, nearly 50% higher than 2015-2019 principal payments and will be $47 million to $56 million during 2024-2028.
- A limited three-member customer base, serves about 113,000 retail electric customers and dilutes the benefits of long-term power supply contracts with members that extend to 2043. Moreover, many of the counties that the utility's members serve have income levels that are 20%-30% below the national median household effective buying income, which we consider as constraining ratemaking and financial flexibility.
- BREC depends almost exclusively on coal units, which exposes the utility to increasingly stringent emissions regulations.
- In addition to existing and proposed emissions regulations' potential limits on market sales opportunities, the utility's market activities face competing natural gas-fired resources that can benefit from the fuel's low prices to the detriment of coal-fired units' dispatch opportunities.
- We believe BREC's few, vintage, coal-fired generation assets present operational exposures that can affect financial performance.
- The utility projects it will maintain relatively stable debt balances of about $800 million through 2019 as it makes necessary capital investments.
- Its 67% debt-to-capitalization ratio is favorable for a cooperative utility.

Henderson, Ky.-based Big Rivers is a generation and transmission cooperative that produces and procures electricity for sale to its three distribution cooperative members and their approximately 113,000 retail customers. The distribution cooperatives are Kenergy Corp., Jackson Purchase Energy, and Meade County Rural Electric Cooperative.

Because the KPSC must approve requests for rate adjustments, the utility and its member distribution cooperatives are distinguishable from many other cooperative utilities that have autonomous ratemaking authority. The commission also regulates BREC's members' rates. It allows the utility to use a fuel adjustment clause to capture changes in variable costs. We believe this tool helps reduce financial volatility.

We consider the rate increases awarded in 2013 and 2014 as reflecting the commission's commitment to the financial viability of the utility, although the KPSC did not provide BREC with its full request for rate relief to offset the customer departures. The commission granted a 15.6% rate increase in October 2013 and a 14.1% increase in April 2014. Its latter decision provided only about half of the utility's 26.5% requested increase.

BREC is temporarily shielding its customers from the effects of the second rate increase by using reserves balances to fund the rate adjustment until it depletes the reserves. Commercial and industrial customers will lose the benefits of the reserves in mid-2015 and residential customers in mid-2016.

Market sales' margins are tempering the financial effects of the customer losses on the remaining customers. BREC is remarketing some of the generation output that previously served the smelters to temper the severity of cost reallocations. We believe that market sales partially transform the utility into a merchant generator that faces the risks inherent in facing volatile market demand and prices. Moreover, we do not view the short-term contracts for its Wilson plant's output as a solution commensurate with the tenor of the utility's more than $850 million of debt. Although BREC is pursuing additional sales contracts, the existing arrangements provide for energy sales only through February 2015 and capacity sales through the first half of 2016.

The utility is also reevaluating its generation portfolio as part of its strategy to reduce costs. It idled its 443 megawatt (MW), coal-fired Coleman power plant and is assessing idling its 417 MW, coal-fired Wilson plant. The generation portfolio also includes 454 MW at the coal-fired Green station and 130 MW in multiple units at the coal and oil-fired Reid Station. We believe that Big Rivers' concentration in coal resources exposes the utility to the potential financial and operational effects of the Environmental Protection Agency's power plant emissions regulations.

The utility reported $853 million of debt as of Dec. 31, 2013. Debt consisted of Rural Utilities Service loans, the Ohio County bonds, and the $537 million loan Big Rivers closed with CoBank ACB and National Rural Utilities Cooperative Finance Corp. in July 2012. In addition to replenishing $35 million of transition reserve funds that had been applied to debt prepayment in 2011, loan proceeds restructured a portion of the utility's RUS borrowing to eliminate some of the spikes in debt service requirements, reduce interest rates, and transition some debt to a mortgage-style amortization. A portion of the 2012 loan reduced 2012's $72.1 million scheduled maturity to $12.1 million, with the remaining $60 million to be amortized later. The loan also retired the $58.8 million maturity of the 1983 PCBs.

In October 2014, the utility secured commitments for a $130 million secured, three-year, revolving credit facility. We consider the syndication's banks' commitments as demonstrating access to capital markets and providing liquidity for working capital, capital expenditures, other general corporate purposes and letters of credit.

Ohio County sold bonds in 2010 for the benefit of BREC, which used bond proceeds to refund auction-rate securities. We understand that the financing structure obligates the utility to unconditionally pay the county's bonds' debt service. Big Rivers issued a note to the county that provides it with a security interest in the utility's assets under its mortgage indenture. The county's bonds' security interest is on par with BREC's senior-secured debt.

Outlook

The stable outlook reflects what we view as sound financial performance in 2013 and 2014 despite the departure of the system's two largest customers. The outlook also reflects our assessment of KPSC rate relief, successful marketing of surplus power, and the utility's demonstrated access to liquidity. Nevertheless, we are maintaining the 'BB-' rating because the lost load exposes the utility's financial performance to the vicissitudes of merchant markets. Furthermore, BREC faces sharply increasing principal amortization that could pressure revenue requirements. If the utility cannot sustain sound financial performance or its members' financial profiles erode because of the lost load, we could lower the ratings. We could raise the ratings if Big Rivers demonstrates a more secure revenue stream together with consistently sound financial performance.

Related Criteria And Research

Related Criteria

USPF Criteria: Applying Key Rating Factors To U.S. Cooperative Utilities, Nov. 21, 2007

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