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Ratings

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Big Rivers Electric Corp., Kentucky Ohio County; Rural Electric Coop

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Long Term Rating	BB+/Stable	Affirmed

Rating Action

S&P Global Ratings affirmed its 'BB+' issuer credit rating on Big Rivers Electric Corp. (BREC), Ky. At the same time, S&P Global Ratings affirmed 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 BREC. The outlook on all ratings is stable.

Credit overview

BREC is a generation and transmission cooperative serving three member distribution cooperatives. Key rating drivers include:

- The wholesale utility's reliance on significant, but declining, market sales where the utility is a price-taker;
- The short tenor of five wholesale power contracts with nonmembers that will help displace market sales;
- The meaningful contributions of industrial customers to its member distribution cooperatives' revenues, which we view as an exposure because of illness related to the coronavirus and measures taken to limit the outbreak, which are taking a toll on economic activity; and
- The utility's almost exclusive reliance on coal-fired generation assets for the electricity it produces, tempered by market purchases that are produced with other fuels.

Moreover, we believe that although projected debt service coverage (DSC) ratios of at least 1.4x in 2020-2021 are robust, they do not fully compensate for the exposures the utility faces. We also take into consideration nonamortizing debt representing 35% of the utility's debt portfolio, which enhances the DSC ratios by approximately 30 basis points compared with a fully amortizing scenario.

Members provided 72% of 2018's operating revenues and revenues from the sale of surplus energy production in competitive wholesale markets provided nearly 30%. BREC projects market revenues will decline to less than 4% by 2023 as its members add steel manufacturer Nucor Corp. as a customer and multi-year contracts between BREC and municipal utility systems begin. Although Energy Information Administration (EIA) data shows that members' energy sales to industrial customers account for 75% of energy sales, BREC reports that it transmits power others produce to two smelter customers and that those sales should be excluded from member energy sales. This adjustment halves

members' energy sales to industrial customers. Adding Nucor will raise industrial concentration to about 50% of member energy sales. The industrial concentration is mitigated by plans to not earn a margin on half of the energy it sells to Nucor. BREC projects that once Nucor opens a new facility within the service territory of distribution member Meade County Rural Electric Cooperative Corp., which it plans to do in 2022, it will help absorb surplus capacity and increase member sales revenues by more than 20%. Although BREC projects the Nucor facility will add a 200-megawatt (MW) load, at the same time, adding the company will expand the customer base's industrial concentration. We view the Nucor load as providing a cushion that can help mitigate any nonrenewals by the municipal contract customers.

BREC has added contracts with municipal utilities that are providing greater and more stable revenues than market sales. These contracts and the Nucor addition will almost eliminate exposure to market sales by 2022. However, because of their tenor, the nonmember contracts will provide only medium-term revenue stream security and predictability. The municipal contracts expire in 2026 and 2029, with 240 MW of the contracted capacity rolling off in 2026 and another 100 MW in 2029. Nucor's 200 MW load should help temper the possibility that BREC is unable to renew the municipal contracts. BREC reports nearly 1,200 MW of generation capacity.

Unlike many other cooperative utilities, BREC does not have autonomous rate-setting authority. Rather, the Kentucky Public Service Commission establishes the cooperative's wholesale rates and its members' retail rates. Tempering the absence of rate-setting autonomy is a history of supportive regulatory decisions and utility projections that assume that BREC will not need rate increases through 2027.

Environmental, social and governance factors

We believe BREC's generation fleet presents meaningful environmental exposures as the national focus on reducing greenhouse gas emissions advances, which could jeopardize generator dispatch and financial performance. The utility's use of coal to produce electricity represented nearly 100% of the utility's self-generation in 2019 and 80% of the electricity BREC sold that year.

Although EIA data show that the residential rates BREC's members charge their customers were 13%-18% higher than the state average in 2018, BREC reports that the EIA data does not reflect member bill credits tied to the use of its rate stabilization fund, which reduce rates by about 5%. Applying this discount, we nevertheless believe the utility presents social risk that could limit financial flexibility, especially in light of income levels and the negative economic pressures of directives to limit the spread of coronavirus. The rate disparities reflect BREC's allocation to remaining customers, and costs from smelter loads lost in 2013. Before their departure, the smelters accounted for about two-thirds of BREC's energy sales. Although the duration of the recently negotiated nonmember contracts is relatively short, we believe that management is mitigating governance risk through efforts to secure purchasers for the surplus capacity that customer departures created. The utility also benefits from a proactive regulator that in addition to overseeing the utility's rates, has demonstrated a commitment to monitoring management and board actions.

Stable Two-Year Outlook

The stable outlook reflects improved prospects for stable financial performance with the anticipated addition of the Nucor load and the medium-term municipal contracts to sell surplus power to nonmember public power utilities. We

view these developments as sharply reducing BREC's exposure to market prices for energy sales, at least through the life of the contracts.

Downside scenario

We could lower the ratings if the utility cannot sustain sound financial performance because of poor prospects for renewing or replacing nonmember contracts, weak market conditions, or poor plant performance. Similarly, if the financial profiles of BREC's members erode, we could lower the ratings. We could also lower the ratings if declining economic activity attributable to the outbreak of coronavirus or measures limiting the spread of COVID-19 negatively affect financial margins.

Upside scenario

We do not expect to raise the ratings within our two-year outlook horizon without prospects for a more secure long-term revenue stream that aligns predictable revenues with debt maturities. We view several additional exposures as constraining the ratings. These include rates we consider high relative to low income levels; an almost exclusively coal-fired generation portfolio and its exposure to more stringent emissions regulations; the presence of nonamortizing debt, which we believe distorts DSC levels relative to utilities with greater percentages of amortizing debt; meaningful industrial loads in a declining economy; and DSC levels that do not compensate fully for these exposures.

Credit Opinion

BREC reported $733 million of debt as of Dec. 31, 2019. About 35% of its debt will not amortize before maturity, which contributes to more robust DSC ratios, relative to utilities with a greater percentage of amortizing debt. The cooperative projects adding 26% more debt through 2021, bringing debt balances up to $921 million. Nevertheless, the utility projects maintaining a favorable debt-to-capitalization ratio for a cooperative utility of 67% in 2021. The aging generation units help reduce the debt to capitalization ratios. With the debt additions, the utility projects robust DSC metrics of at least 1.4x through 2022. We performed a scenario analysis that suggests that coverage would be about 30 basis points lower if the cooperative had a fully amortizing debt portfolio.

Although we view coverage levels and liquidity as providing resilience, our rating conclusions assign significant weight to the relative brevity of the municipal power sales agreements. If BREC is unable to renew these contracts and must rely on market sales for margins, we believe the utility could be vulnerable to earning comparatively thin margins in competitive markets, compared with those it earns under the municipal contracts. At the same time, we view favorably the addition of Nucor as a members' customer, as helping reduce market exposure. Additional factors we view as constraining the rating include the industrial concentration among members' customers, and members' high retail rates that can limit financial flexibility when viewed through the lens of the state's low income levels.

We view external liquidity facilities as providing an added measure of lender protection. External facilities increase balance-sheet liquidity from a weak 40 days' operating expenses to about four months' operating expenses.

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