S&P Global
Ratings

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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	BBB-/Stable	Upgraded

Rating Action

S&P Global Ratings raised to 'BBB-' from 'BB+' its issuer credit rating on Big Rivers Electric Corp. (BREC), Ky. The outlook is stable.

Credit overview

The higher rating reflects the enhanced revenue-stream stability we expect the utility will derive from a member utility's significant and imminent retail load addition and the predictable revenues from off-system sales to municipal utilities under intermediate-term contracts. We believe these developments will complement Big Rivers' consistently strong financial margins by sharply reducing dependence on sales of surplus generation output in competitive markets. Moreover, management forecasts halving debt through the end of the decade, which will contribute to favorable leverage metrics.

Although we believe management actions and load growth should enhance revenue-stream predictability and stability, we nevertheless associate operational risks with this utility that constrain the rating. These exposures include:

- An extremely high coal concentration that accounted for 100% of self-generation in 2018-2020 and 70%-80% of energy sold;
- The potential costs of substituting cleaner generation resources for existing generation to comply with regulatory and legislative carbon-reduction initiatives;
- The BREC system's significant reliance on revenues from industrial customers; and
- The service territory's weak income levels.

BREC is a generation and transmission cooperative serving three member distribution cooperatives.

Following the loss of two smelter loads in 2013, BREC has relied on sales of surplus energy production in competitive wholesale markets to augment member revenues. We view market sales as exposing utilities to unpredictable revenues. Sales to members provided 72% of operating revenues in 2020, with the balance principally coming from market sales. However, BREC projects market revenues will decline to nominal levels by 2023 as its members add a 200-megawatt (MW) load from steel manufacturer Nucor Corp. and power sales continue under multi-year contracts between BREC and municipal utility systems. BREC projects that Nucor will account for approximately 20% of its post-2022 electric sales. Although the municipal contracts expire in 2026 (240 MW) and 2029 (100 MW), BREC

projects that adding Nucor sales will reduce market exposure to modest, single-digit percentage levels. Nucor will add to the BREC system's industrial concentration.

Unlike many other cooperative utilities, BREC does not have autonomous rate-setting authority. Rather, the Kentucky Public Service Commission (PSC) 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 of modest rate increases.

The stable outlook reflects improved prospects for stable financial performance based on sales to non-member municipal utilities and the imminent commencement of sales to Nucor. We expect these developments will sharply reduce BREC's reliance on volatile market prices for energy sales.

Environmental, social and governance (ESG) factors

We believe BREC's generation fleet presents significant environmental exposures as the national focus on reducing greenhouse gas emissions advances. The use of coal to produce electricity continued to represent almost 100% of the utility's self-generation in 2020 and 80% of the electricity BREC sold that year. Management recently received PSC approval to convert its Green generating station to burn natural gas. However, the Wilson generating station, which supports a greater share of self-generation, will continue to burn coal. Wilson accounted for two-thirds of 2020 generation from owned resources and Green, only one-third.

EIA data show that residential rates are 10%-13% higher than state averages in 2019, which we view as creating social risks that could limit financial flexibility, especially if the utility needs to secure cleaner generation resources while recovering undepreciated costs of existing resources. The state's high poverty rate, which pervades portions of the service territory, compounds affordability issues and social risks.

We believe management demonstrated favorable governance attributes through its pursuit of contracts for sales of the output of surplus generation capacity to non-member utilities to temper market exposure. Securing contracted and off-system sales also allocated to non-members fixed costs that were historically absorbed by smelter loads prior to their 2013 departure. 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 Outlook

Downside scenario

We could lower the rating if the utility cannot sustain sound financial performance because of carbon-reduction costs or economic dislocations among the utility's industrial customers.

Upside scenario

Although management has made considerable strides in enhancing the stability and predictability of the revenue stream, we do not expect to raise the rating within our two-year outlook horizon. We believe the utility faces several material exposures that strong financial metrics do not fully offset. The exposures include a substantial carbon dependence, a significant reliance on industrial customers, and rates that we consider high relative to low income levels.

Credit Opinion

BREC reported $700 million of debt as of Dec. 31, 2020, and projects reporting $840 million of debt at year-end 2021, reflecting additional issuance. Nevertheless, the utility projects halving debt balances incrementally by the end of the decade and maintaining a favorable debt-to-capitalization ratio for a cooperative utility of 57%-65% through 2024. The utility also projects robust debt service coverage metrics of at least 1.7x through 2024, with the exception of lower coverage in 2023, due to that year's large maturity. Unrestricted balance sheet cash, together with capacity remaining under committed lines, provided liquidity equivalent to more than eight months' operating expense, net of depreciation.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020