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Ratings

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Summary:

Big Rivers Electric Corp., Kentucky; Rural Electric Coop

Primary Credit Analyst:
David N Bodek, New York + 1 (212) 438 7969; david.bodek@spglobal.com

Secondary Contact:
Timothy P Meernik, Centennial + 1 (303) 721 4786; timothy.meernik@spglobal.com

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Long Term Rating	BBB/Stable	Upgraded

Rating Action Overview

- S&P Global Ratings raised its issuer credit rating on Big Rivers Electric Corp. (BREC), Ky., to 'BBB' from 'BBB-'.
- The outlook is stable.
- The higher rating reflects our view of load growth that should contribute to revenue stability, coal fleet and carbon-intensity reductions, and favorable historical and projected financial metrics.

Security

BREC's long-term debt is secured by property pledged under its mortgage indenture. The indenture obligates the utility to establish rates that are expected to yield a margins-for-interest ratio of 1.1x in each fiscal year.

Although we do not rate the utility's privately placed debt, we factor these debt balances in our assessment of BREC's credit quality. As of Dec. 31, 2021, the utility reported $757 million of long- and short-term debt, which management projects will increase to $956 million in 2022 in connection with repowering projects, before declining to $728 million in 2025.

Credit overview

Three large retail electric loads are investing $50 million-$1.7 billion in new facilities for their businesses within the service territories of BREC's member cooperatives. These new and expanded facilities should translate into electricity consumption that can support a more predictable revenue stream and help shield BREC from becoming dependent on revenues from energy sales in competitive wholesale markets if non-member municipal customers do not renew existing intermediate-term contracts for purchases of BREC power.

The cooperative is reducing its carbon intensity through the recent conversion of a portion of the utility's coal generation fleet to natural gas.

The cooperative's debt service coverage was at least 1.6x in fiscal years 2020-2021 and reasonable projections indicate stronger coverage through fiscal 2025, except for fiscal 2023 when management plans to extinguish about half of a bullet maturity with cash and the balance through a refinancing.

Constraining the rating are:

- BREC members' significant dependence on revenues from industrial customers that we view as more vulnerable to economic cycles than residential customers;

- The service territory's weak income levels that could limit the utility's ratemaking flexibility; and
- Coal's ongoing substantial contribution to generation despite retirements of portions of the coal-fired generation fleet.

BREC is a generation and transmission cooperative that derived almost half of its 2021 operating revenues from three distribution cooperatives and the balance principally from sales to non-member utilities with whom it has contracts. BREC earns the remainder of its revenues from market sales.

Following the loss of two aluminum smelter loads that accounted for about two-thirds of energy sales almost a decade ago, the utility faced a long generation position. To mitigate the cooperative's exposure to volatile power markets, management contracted to sell much of the surplus power to municipal utilities under contracts expiring in 2026 and 2029. More recently, Nucor Corp. is developing a $1.7 billion steel plate manufacturing plant in Brandenburg, Blockware Mining is constructing a $50 million cryptocurrency server facility in Paducah, and Pratt Industries is constructing a $500 million paper mill in Henderson. These facilities will add 300 megawatts (MW) of load or almost 90% of the load the municipalities contribute. The industrial load additions should temper exposure to merchant energy markets if the municipal utility systems do not renew their wholesale power purchase agreements with BREC when they expire in the latter part of the decade. If the municipal customers extend their contracts, the cooperative might need to secure through contracts or construction additional generation resources to simultaneously serve those customers and the industrial loads the system is adding.

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 principally through the utility's formulaic, monthly fuel clause and purchased power cost mechanisms.

Coal accounted for 100% of 2021's self-generation and self-generation supported 83% of the year's energy sales. This year, BREC completed its conversion of its two Green station generation units to natural gas. Based on the gas conversions and plans to add contract purchases of solar electricity, management projects coal's contribution to total energy sources will decline to 52% by 2025 from 83% in 2021. Although coal will continue to comprise a substantial portion of energy sales, the meaningful reductions should temper the cooperative's financial exposure to potentially more stringent federal emissions regulations.

Environmental, social, and governance

Although BREC projects reducing coal-fired megawatt-hours by 41% by 2025 relative to 2021 because of the conversion of its Green station units to natural gas, coal-fired electricity from the larger Wilson station will continue to account for 52% of energy sales, which we view as placing moderate negative pressure on the credit quality of the cooperative.

Energy Information Administration data show that residential rates are 10% higher than state averages, which we view as creating social risks that could limit financial flexibility, especially in an inflationary environment that creates a need for rate increases to cover higher operating, capital, and borrowing costs. The state's high poverty rate, which pervades portions of the service territory, compounds affordability issues and social risks, which we consider to be moderately negative to credit quality.

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 and to more efficiently allocate fixed costs previously borne by industrial customers that severed their ties with BREC in 2013. In addition, the utility benefits from a proactive regulator that in addition to overseeing the utility's rates, has demonstrated a commitment to monitoring management and board actions and financial performance.

Outlook

The stable outlook reflects reduced risk of long-term exposure to competitive wholesale markets; lower carbon intensity; and projections of continued sound debt service coverage, liquidity, and leverage.

Downside scenario

We could lower the rating if the utility cannot sustain sound financial performance because of carbon-reduction costs or if the industrial customers, despite their substantial investments in facilities within BREC's service territory, experience economic dislocations.

Upside scenario

Although we believe load growth and management actions have enhanced the stability and predictability of the revenue stream, we do not expect to raise the rating further within our two-year outlook horizon. We believe the utility continues to face material exposures that include a substantial carbon dependence, a significant reliance on industrial customers, and rates that we consider high relative to low income levels.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022