

Global Credit Research - 14 Jul 2011

Tampa, Florida, United States

## Ratings

Category	Moody's Rating
Outlook	Stable
First Mortgage Bonds	A3

## Contacts

Analyst	Phone
Kevin G. Rose/New York	212.553.0389
Chee Mee Hu/New York	212.553.3665

## Key Indicators

### [1]Seminole Electric Cooperative, Inc.

	2010	2009	2008	3-Year Avg
TIER [2]	1.8x	1.4x	1.1x	1.4x
DSCR [2]	1.5x	1.3x	1.1x	1.3x
FFO / Debt	9.2%	6.1%	3.8%	6.4%
FFO + Interest / Interest	2.8x	2.2x	1.9x	2.3x
Equity / Capitalization	12.6%	9.2%	6.5%	9.4%

[1] All ratios calculated in accordance with Moody's Electric G&T Cooperative Rating Methodology using Moody's standard adjustments [2] Moody's definitions may differ from indenture covenants

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

## Opinion

### Rating Drivers

Virtually all energy sales are made under long-term wholesale power contracts

Departure of a member cooperative proceeds smoothly

Autonomous rate setting authority

Adequate generation capacity limits future capital expenditure needs over the medium term

Improved financial profile

### Corporate Profile

Seminole Electric Cooperative is among the nation's largest not-for-profit electric generation and transmission cooperatives, which provides for the power supply needs of its ten member distribution cooperative owners who in turn serve over 900,000 predominantly residential meters throughout 45 counties in Florida. Energy sales to Seminole's residential customers comprised about 70% of 2010 total sales to members, with the balance going to mostly commercial and some industrial customers.

Seminole's power supply portfolio includes about 2,165 megawatts (MW) of owned (primarily fossil fueled) capacity, including two equally sized units at the 1,300 MW coal-fired Seminole Generating Station (SGS) and the 850 MW natural gas-fired Midulla Generating Station (MGS). Seminole also has a 15 MW (1.7%) undivided ownership in Progress Energy Florida's (PEF) 860 MW Crystal River Unit No. 3 nuclear power plant. The cooperative supplements its owned capacity with a mix of short and long-term capacity and energy purchase contracts with other utilities and independent power producers. With these contracts, Seminole has available about 3,508 MW of generating capacity under purchase power agreements (PPAs).

### Recent Developments

On July 13, 2011, Moody's affirmed Seminole's A3 senior secured rating and its stable rating outlook. The affirmations primarily reflect our view that the cooperative will be able to maintain its solid financial and liquidity profiles and our expectation that the departure process of a member owner cooperative will take place smoothly. (See press release announcement of July 13, 2011 for further details).

### **Rating Rationale**

Seminole's A3 senior secured rating reflects its generally low business risk profile supported by long-term wholesale power contracts (WPC) with its members and relatively cost effective supply portfolio available to meet members needs. The rating also takes into account significant rate flexibility, given the absence of rate regulation by the state commission, the existence of fuel and purchase power pass through mechanisms and reduced capital spending requirements over the next several years. Moreover, Seminole's interest and debt coverage metrics have recently improved, albeit in part due to the positive effects of weather, and it is following an equity development plan to strengthen a historically weak balance sheet as past capital investments have been primarily debt financed. The rating also reflects Seminole's successful replacement of liquidity facilities that expired in December 2010 on satisfactory terms. Concerns over the medium to long term relate mostly to a relatively high dependence on purchased power, potential effects of carbon regulation given Seminole's dependence on coal generation capacity and the extent to which members might exercise options to take a portion of their power supply needs from alternative suppliers beginning in 2021 as permitted under recently extended WPCs.

Moody's basis for rating Seminole Electric Cooperative, Inc. is guided by the Rating Methodology for U.S. Electric Generation & Transmission Cooperatives (the Rating Methodology), published in December 2009. According to the Rating Methodology, Seminole maps exactly to its A3 senior secured rating (see table below).

### **DETAILED RATING CONSIDERATIONS**

#### **LONG-TERM WHOLESALE POWER CONTRACTS WITH MEMBERS**

Since 1975, Seminole has maintained all-requirements long-term WPCs with its ten member owners, which we view as a significant benefit to the cooperative's creditworthiness. Under the WPCs, virtually all of Seminole's revenues have been derived from sales to members and each member is obligated to pay a pro-rata share of demand and energy charges to cover all of Seminole's costs related to generation and transmission services provided. In 2010, energy sales to members accounted for about 97% of Seminole's total energy sales.

Currently, nine of Seminole's members have extended their contracts by 25 years through 2045 (well beyond the longest dated debt maturity in 2042), while the second largest member, Lee County Electric Cooperative, chose not to do so. In extending the contracts, the nine members now have the added flexibility of a partial requirements option. These members can choose, subject to three-year notice requirements, to obtain a portion of their respective growth energy requirements and certain other future energy needs from other suppliers beginning in 2021. It is important to note that this option can be exercised only once. Such options are becoming increasingly prevalent throughout the sector in conjunction with periodic extensions of the WPC and represent a modest increase in the sector's overall business risk profile. While this added flexibility allows for Seminole's members to make future energy purchases from other sources, the members remain obligated to funding fixed capacity costs committed to by Seminole to that point, thereby assuring that Seminole will not be exposed to stranded costs.

#### **DEPARTURE PROCESS OF LEE COUNTY IS PROCEEDING SMOOTHLY**

Overall, the Lee County exit from Seminole's member base is considered credit negative, as it could indicate a fundamental impact to the long-term all-requirements contract relationships that exist today with other members. Currently, Lee County's membership is scheduled to terminate at the end of 2013, and the exit process is being conducted over a multi-year period. At the end of 2009, Lee County's load was phased down by approximately one third of its original load, and as part of the second and final step of the process, its remaining load is scheduled to be eliminated entirely when its WPC terminates in December 2013. Under the current terms and conditions for the exit, no payments on the part of either party is required upon termination of the WPC.

Although the exit of Seminole's second largest member is viewed negatively overall, Moody's recognizes some of its positive attributes to Seminole's credit profile. For example, Seminole's acceptance of the termination of Lee County's membership ahead of the prior July 30, 2020 contract expiration date was somewhat based upon the fact that the termination coincides with the expiration of some of Seminole's current PPAs, and that management expected it would not need additional PPAs or owned generation capacity for load growth of its remaining members. As such, Seminole curtailed earlier plans for generation capacity expansion, which reduces capital financing requirements over the medium term. Moreover, remaining members can benefit from additional access to existing cost effective resources.

#### **RATE AUTONOMY ENSURES EFFICIENT AND TIMELY RECOVERY OF COSTS**

The A3 senior secured rating also incorporates Seminole's rate autonomy and flexibility that provides significant credit strength. As noted above, Seminole's (and its distribution members') rate level is not subject to Florida Public Service Commission (FPSC) jurisdiction; however, the FPSC does have the ability under Florida state law to assess rate design issues among various customer classes. Given its rate autonomy, Seminole has the flexibility to increase base rates via board reviews and to automatically pass through variations in its fuel costs through a semi-annual true-up mechanism. In certain circumstances, management can recommend that the board approve such adjustments more frequently. Moreover, the board reviews base rates at least annually and has demonstrated a willingness to increase rates in a timely manner, most recently authorizing a 7.8% increase in the average member rate for 2009.

Seminole's wholesale rates (about 83.83 mills per kWh in 2010) are relatively competitive compared to other investor-owned and municipal utilities in Florida, although some utilities with a heavy gas portfolio may present more favorable rates due to persistently low natural gas prices at the moment. Nevertheless, the management team believes it remains in a fairly competitive position versus other wholesale electricity providers on the peninsula of Florida, which tempers concern that members might offer resistance to future price increases. Also, Seminole's members pose little counterparty risk under the WPC, as they have generally maintained a solid financial profile, including consolidated equity to capitalization in excess of 45%.

#### **REDUCED CAPEX REQUIREMENTS AND INCREASED FINANCING FLEXIBILITY**

Seminole's rating also reflects reduced future capital expenditure requirements in the near to medium term (setting aside uncertainties regarding potential future environmental related investments), and its associated benefit of financial flexibility. Seminole's annual capital expenditures averaged approximately \$100 million for the 2007-2010 period, whereas the spending is currently projected to be in the \$50-\$60 million range annually over the next four years. The reduction in future capital expenditure requirements is largely attributable to Seminole's

already significant owned and purchased generation capacity portfolio, and to the decline in future load demand due to Lee County's scheduled exit from the member base. It is our understanding that management believes Seminole has sufficient peaking and base/intermediate capacity until at least 2017 and 2021, respectively.

With substantially reduced capital expenditures on the horizon, Seminole's financing requirements will correspondingly be less, which could foster further improvement in financial metrics as discussed further below. We also note that Seminole released and canceled its previously existing Rural Utilities Service (RUS) mortgage effective March 2010, by recording and perfecting its own indenture of mortgage that the RUS approved. Now Seminole can continue to borrow from the RUS under a government subsidized loan program, but also has the additional flexibility to access the private and public debt markets without first obtaining RUS lien accommodations. The additional flexibility is increasingly important from our perspective given the existing RUS loan moratoriums for certain types of investments related to new base-load coal and nuclear generation plants.

#### **IMPROVED FINANCIAL METRICS; EQUITY GROWTH PLANS**

Seminole has achieved improvement in its financial metrics in recent periods as the board of trustees took timely actions to adjust the wholesale rate in support of maintaining a cushion in meeting minimum required times interest earned ratio (TIER) and debt service coverage (DSC) metrics relative to financial covenants in the previously existing RUS mortgage. We also emphasize that some of the recent improvement is directly attributable to increased sales volume due to the unusually cold winter and hot summer during 2010. Specifically, during 2008-2010 Seminole's three-year average TIER and DSC metrics of 1.4x and 1.3x, respectively, were both above the minimum required covenant levels of 1.05x and 1.0x, respectively. We take a credit positive view when management achieves in excess of thin minimum required covenant levels typically present in RUS mortgages.

Seminole's other key metrics also demonstrated improvement, as funds from operations (FFO) to debt and FFO coverage of interest increased from 3.8% and 1.9x, respectively, in 2008 to 9.2% and 2.8x, respectively, in 2010. Although the improvement is partially attributable to favorable weather conditions in 2010 that resulted in load demand growth, it is also due to the 2009 wholesale power rate increase mentioned above. Going forward, we anticipate that Seminole can generate annual FFO close to \$100 million, thereby providing a basis for solidly positioning its A3 senior secured rating under the Rating Methodology.

Under its new indenture of mortgage, Seminole is now governed in part by a minimum required margins for interest (MFI) metric of 1.1x and must also achieve at least a 20% equity to total capitalization ratio before it can resume retirement of patronage capital (i.e. equivalent to a common dividend payment). Seminole's board of trustees has approved an equity development plan that targets compliance with the MFI covenant in each year and attaining at least a 20% equity to total assets level by the end of 2014. We anticipate the board will modify its equity development program to conform to achieving 20% equity to capitalization by the end of 2014. Taking into account Moody's standard adjustments, Seminole's equity to capitalization stood at 12.6% as of December 31, 2010.

#### **Liquidity**

Seminole demonstrates a good liquidity profile. In 2010, its internally generated cash flow of \$133 million was more than sufficient to cover its capital outlays of \$43.5 million, and as a part of its equity development plan mentioned above, it did not return any patronage capital to its members. In addition, during 2010 Seminole kept its average daily balance of member prepayments at about \$150 million, and at March 31, 2011 it also had approximately \$122.6 million of cash and cash equivalents on hand. We anticipate that members will continue to participate in the prepayment program to the extent that they have excess cash available.

To supplement internally generated cash flow and access to funds under the member bill prepayment program, Seminole currently maintains access to external liquidity through three separate committed bank credit facilities in the aggregate of \$200 million. These include two separate three-year \$75 million facilities with National Rural Utilities Cooperative Finance Corp. (NRUCFC) and CoBank, and a three-year \$50 million facility with Bank of America. All three facilities expire in December 2013. We understand that management has negotiated amendments and extensions of these three facilities through December 2015, which are expected to be finalized by the end of July 2011. Seminole's existing facilities do not include the material adverse change clause as part of the representations and warranties for each borrowing, thereby enhancing the quality of those sources of liquidity. As of March 31, 2011, Seminole had no borrowings outstanding under the bank facilities. In addition to these committed facilities, Seminole has also secured about \$113 million of approved RUS loans available for draw, which are intended for financing of generation and transmission capital improvements.

Going forward, we anticipate that Seminole will continue to demonstrate a satisfactory liquidity profile, given the anticipated reduction in planned capital expenditures, strong level of internally generated cash flows and ample unused capacity under the committed bank facilities. Furthermore, no capital returns to members are expected to occur until the required 20% equity to capitalization level is attained.

#### **Rating Outlook**

Seminole's stable rating outlook reflects good prospects that the cooperative can sustain its solid financial and liquidity profiles and avoid any material disruptions as Lee County completes its exit from the Seminole system.

#### **What Could Change the Rating - Up**

A positive rating action could occur if Seminole demonstrates sustainable improvement in its financial performance and there is further evidence that Lee County's exit from the Seminole system is proceeding smoothly. In terms of financial metrics, if Seminole can achieve FFO to debt and FFO to interest over 9% and 2.4x, respectively, for an extended period, an upgrade could occur.

#### **What Could Change the Rating - Down**

Although a negative rating action is unlikely in the medium term, Seminole's rating could be pressured or the rating outlook could be revised to negative if unexpected challenges develop as Lee County exits its membership or any disruptions to the currently strong relationships with the remaining nine members develop. Also, if future environmental related costs create undue new debt financing requirements that cause FFO to debt and FFO to interest metrics to deteriorate and stay below 6% and 2.0x for an extended period, then downward rating action could occur.

#### **Rating Factors**

**Seminole Electric Cooperative, Inc.**

<b>U.S. Electric Generation &amp; Transmission Cooperatives</b>	<b>Aaa</b>	<b>Aa</b>	<b>A</b>	<b>Baa</b>	<b>Ba</b>	<b>B</b>
<b>Factor 1: Wholesale Power Contracts &amp; Regulatory Status (20%)</b>						
a) % Member Load Served & Regulatory Status			X			
<b>Factor 2: Rate Flexibility (20%)</b>						
a) Board Involvement / Rate Adjustment Mechanism		X				
b) Purchased Power / Sales %				34%		
c) New Build Capex (% Net PP&E)		X				
d) Rate Shock Exposure						X
<b>Factor 3: Member / Owner Profile (10%)</b>						
a) Residential Sales / Total Sales			70%			
b) Members' Consolidated Equity / Capitalization				48%		
<b>Factor 4: 3-Year Average Financial Metrics (40%)</b>						
a) TIER		1.4x				
b) DSC			1.3x			
c) FFO / Debt			6.3%			
d) FFO / Interest			2.3x			
e) Equity / Capitalization				9.4%		
<b>Factor 5: Size (10%)</b>						
a) MWh Sales (Millions of MWhs)			17.4			
b) Net PP&E (\$billions)			\$1.3			
<b>Rating:</b>						
a) Indicated Rating from Methodology			A3			
b) Actual Rating Assigned (Senior Secured)			A3			



© 2011 Moody's Investors Service, Inc. and/or its licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

**CREDIT RATINGS ARE MOODY'S INVESTORS SERVICE, INC.'S ("MIS") CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MIS DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS DO NOT CONSTITUTE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS ARE NOT RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. CREDIT RATINGS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MIS ISSUES ITS CREDIT RATINGS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.**

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources Moody's considers to be reliable, including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The ratings, financial reporting analysis, projections, and other observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. Each user of the information contained herein must make its own study and evaluation of each security it may

consider purchasing, holding or selling. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MIS, a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MIS have, prior to assignment of any rating, agreed to pay to MIS for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at [www.moody.com](http://www.moody.com) under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Any publication into Australia of this document is by MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657, which holds Australian Financial Services License no. 336969. This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001.

Notwithstanding the foregoing, credit ratings assigned on and after October 1, 2010 by Moody's Japan K.K. ("MJKK") are MJKK's current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. In such a case, "MIS" in the foregoing statements shall be deemed to be replaced with "MJKK". MJKK is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO.

This credit rating is an opinion as to the creditworthiness or a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be dangerous for retail investors to make any investment decision based on this credit rating. If in doubt you should contact your financial or other professional adviser.