

Global Credit Research - 19 Jul 2010

Tampa, Florida, United States

## Ratings

Category	Moody's Rating
Outlook	Stable
First Mortgage Bonds	A3

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## Key Indicators

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

	2009	2008	2007	3-Year Avg
TIER [2]	1.4x	1.1x	1.2x	1.2x
DSCR [2]	1.3x	1.1x	1.1x	1.2x
FFO / Debt	6.1%	3.8%	5.0%	5.0%
FFO + Interest / Interest	2.2x	1.9x	2.0x	2.0x
Equity / Capitalization	9.2%	6.5%	7.8%	7.8%

[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

Rate structure autonomy

Adequate generation capacity limits capex spending over the medium term

Liquidity facilities expire in December 2010; sound interest and debt coverage; equity growth plans

### 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 46 counties in Florida. Energy sales to Seminole's residential customers comprised about 69% of 2009 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 3,227 MW of generating capacity under purchase power agreements (PPAs). Management believes Seminole has sufficient peaking and base/intermediate capacity until at least 2017 and 2021, respectively.

### 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 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 and it is following an equity development plan to strengthen a historically weak balance sheet as capital investments have been primarily debt financed. Key near term concerns are the need to replace existing liquidity facilities expiring in December 2010 on satisfactory terms and the effects of the Florida economy. Additional concerns over the medium to long term relate mostly to a relatively high dependence on purchased power, potential effects of federal carbon legislation 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.

Most recently, nine of Seminole's members 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. 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.

Meanwhile, Lee County has taken a highly unusual step by deciding to exit its membership within the Seminole family effective December 31, 2013 under terms and conditions that require no payments on the part of either party upon termination of the WPC. Under the basic terms, Seminole will continue to serve about 70% of Lee County's load (approximately 19% of Seminole's total member load) from January 1, 2010 through December 31, 2013 and Lee County's patronage capital will be retired on the same schedule as Seminole's remaining nine members. Although the early termination of a WPC between a G&T cooperative and one of its members is highly unusual, Seminole accepted the termination of Lee County's membership ahead of the prior July 30, 2020 contract expiration date because it will coincide with the expiration of some of Seminole's current PPAs and management's expectation for load growth at 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. Nevertheless, we view distribution member exits negatively, as it could indicate a fundamental impact to the long-term all requirements contract relationships.

### **AFFORDABLE RATES AND RATE AUTONOMY**

Seminole charges a wholesale rate to its members which has increased from 64.64 mills per kilowatt hour (kWh) in 2005 to 80.32 mills per kWh in 2009. Nevertheless, the company believes it remains in a good competitive position versus other wholesale electricity providers in 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 40%.

Importantly, Seminole has the flexibility to automatically pass through variations in its fuel and purchased power 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. Such increases, be they base or variable cost driven, can be made without any regulatory intervention by the Florida Public Service Commission. This rate setting autonomy is a credit strength for Seminole, albeit one that is also prevalent for most of its peers.

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

Seminole incurred capex of almost \$880 million over 2005 - 2009, which was considerably higher on average than the historical average annual routine capex of about \$35 million. The higher spending was primarily driven by construction of 300 MW of additional peaking capacity at MGS and investments in environmental control equipment at both SGS and MGS, which was mostly debt financed.

As Seminole addressed future capacity needs through additional PPAs, its future construction budget has been substantially reduced from earlier reports well in excess of \$2.0 billion that included amounts for potential construction of a third 750 MW coal-fired unit at SGS. We now understand that Seminole's aggregate capex for the 2010- 2014 period is expected to be in area of \$250 million, which is supportive of a strong Aa mapping for Seminole under the Rating Methodology's sub-factor related to new build exposure. Although spending is likely to remain slightly above routine levels for 2010 and 2011 as some smaller scale environmental projects are addressed at SGS and MGS, we anticipate that annual capex beyond 2011 will revert to more routine levels in the \$30 million to \$40 million range to address replacement and upgrades of existing infrastructure. Longer term, Seminole could consider construction of additional natural gas fired capacity at its Gilchrist site in Florida and would also consider a minority participation in any new nuclear plant construction ultimately pursued by PEF.

With substantially reduced capex on the horizon, Seminole's financing requirements will correspondingly be less and foster further improvement in financial metrics as recently noted and detailed 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. Moreover, under the current federal budget proposals, we understand that such moratoriums could be extended to also include any investments related to certain fossil-fueled generation assets (i.e., environmental controls).

#### **SOUND INTEREST AND DEBT COVERAGES; EQUITY GROWTH PLANS**

Seminole's board of trustees has taken timely actions in recent periods 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. To this end, Seminole has, on average, over 2007 - 2009 produced TIER and DSC metrics of 1.2x and 1.2x, respectively, in both instances above the minimum covenant levels of 1.05x and 1.0x, respectively, required for at least two of the past three fiscal years. We take a credit positive view when management achieves in excess of thin minimum required covenant levels typically present in RUS mortgages.

The 7.8% increase in Seminole's wholesale rate approved for 2009 resulted in improved net margin and funds from operations, thereby strengthening the key metrics such as funds from operations (FFO) to debt and FFO coverage of interest to 6.1% and 2.2x, respectively, for 2009. Going forward, we anticipate that Seminole can generate FFO in excess of \$100 million annually, thereby providing a basis for further strengthening of these metrics in support of, and potentially improving, the 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 9.2% as of December 31, 2009, which is relatively low, thereby requiring significant progress before achieving the 20% target.

#### **Liquidity**

To supplement internally generated cash flow and access to funds under the member bill prepayment program, Seminole currently maintains access to external liquidity through two separate committed bank credit facilities. These include a two year \$100 million facility with National Rural Utilities Cooperative Finance Corp. (NRUCFC) and a \$100 million 364-day facility with CoBank. Both facilities expire December 31, 2010, which represents a near-term liquidity risk concern in the event that satisfactory replacement arrangements are not finalized ahead of the expiration date. Importantly, Seminole is actively negotiating with NRUCFC, CoBank and other commercial banks to replace the two existing facilities with at least three new multi-year tenor committed facilities that will aggregate \$200 million. As part of this process, Seminole already successfully amended the existing NRUCFC and CoBank facilities effective July 15, 2010 to eliminate the applicability of the material adverse change clause as part of the representations and warranties for each borrowing, thereby improving the quality of those sources of liquidity. Moreover, we understand that at least two commercial banks have bid for relationships with Seminole, making it likely that at least one commercial bank will become part of Seminole's future banking relationships, thus diversifying the sources of committed bank liquidity and potentially downsizing the size of facilities with NRUCFC and CoBank. Management plans to request Board approval later this summer for at least \$200 million of new three-year committed bank credit and has indicated that proposed terms and conditions per draft documents will include financial covenants similar to those in Seminole's indenture of mortgage and will not have any ongoing MAC clause or rating triggers.

We believe that Seminole has sufficient access to liquidity assuming the existing facilities are addressed as described above. As of June 30, 2010, Seminole had about \$153 million in its member prepayment program available to pay certain future member power bills through August 2011. We anticipate that members will continue to participate in this program to the extent that they have excess cash available. Seminole also has about \$70 million of approved RUS loans available for draw and management expects to take down about \$30 million later this year and \$40 million in 2011. An additional RUS loan application in the amount of \$114 million is pending approval expected by September 2010.

Meanwhile, as of June 30, 2010 Seminole had about \$17 million of unrestricted cash on hand and no draws under its existing bank credit. Calls on cash over the next four quarters include estimated capex of \$70 million and about \$57 million of debt principal payments; no capital returns to member will occur until the required 20% equity level is attained. Beyond the next four quarters, capex is expected to be about \$70 million for 2011 and debt principal payments are reported around \$60 million for each of 2011 and 2012.

#### **Rating Outlook**

Seminole's stable rating outlook includes our assumption that liquidity will be shored up ahead of the impending expirations of existing bank facilities and that the cooperative will maintain a sound financial profile consistent with its A3 senior secured rating given limited financing and rate relief needs over the next few years. While we view management's approach to handling its credit facility extension so close to its expiration date as less than ideal, particularly in light of today's more challenging bank credit environment, we believe that the recent success in amending existing facilities evidences good relationships that should facilitate a smooth and timely extension of the facilities in advance of the December 2010 expiry date.

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

A positive rating action could occur if Seminole smoothly transitions through the period of time as Lee County exits from the system. In terms of financial metrics, if Seminole can strengthen its FFO to debt and FFO to interest to over 9% and 2.4x, respectively, for an extended period, then momentum for an upgrade would build.

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

Any problems extending Seminole's bank credit facilities would result in negative rating action. Seminole's rating could also be pressured if unexpected challenges develop as Lee County exits its membership at the end of 2013 and/or there is passage of federal carbon related legislation that creates undue cost burdens that compromise relationships with the remaining 9 members. Also, if key metrics such as FFO to debt and FFO to interest deteriorate and stay below 6% and 2.0x for an extended period, then downward rating action could occur.

## Rating Factors

### Seminole Electric Cooperative, Inc.

U.S. Electric Generation & Transmission Cooperatives	Aaa	Aa	A	Baa	Ba	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 %					43%	
c) New Build Capex (% Net PP&E)		18%				
d) Rate Shock Exposure						X
<b>Factor 3: Member / Owner Profile (10%)</b>						
a) Residential Sales / Total Sales			69%			
b) Members' Consolidated Equity / Capitalization				45%		
<b>Factor 4: 3-Year Average Financial Metrics (40%)</b>						
a) TIER			1.2x			
b) DSC			1.2x			
c) FFO / Debt				5.0%		
d) FFO / Interest			2.0x			
e) Equity / Capitalization				7.8%		
<b>Factor 5: Size (10%)</b>						
a) MWh Sales (Millions of MWhs)			17.2			
b) Net PP&E (\$billions)			\$1.4			
<b>Rating:</b>						
a) Indicated Rating from Methodology			A3			
b) Actual Rating Assigned (Senior Secured)			A3			



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